Office - Supreme Court, U.S.
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82-215

No.

In the Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether a bankruptcy court in a reorganization proceeding under Chapter 11 of the Bankruptcy Code may compel the government, pursuant to 11 U.S.C. (Supp. IV) 542(a), to turn over property to the debtor-in-possession, where the government had seized the property by levy prior to the filing of the bankruptcy petition to satisfy the debtor's delinquent federal tax liabilities.

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UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-32a) is reported at 674 F.2d 144. The opinions of the district court (App. C, *infra*, 46a-51a) and the order, memorandum and decision of the bankruptcy court (App. B, *infra*, 33a-45a) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on March 9, 1982. By orders dated May 28 and June 28, 1982, Justice Marshall extended the time for filing a petition for a writ of certiorari to and including August 6, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(a).

STATUTES INVOLVED

Sections 363, 541, and 542 of the Bankruptcy Code (11 U.S.C. (Supp. IV)) and Section 6331 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in App. D, *infra*, at 52a-56a.

STATEMENT

Respondent is a corporation which was engaged in the business of installing and servicing swimming pools and selling related supplies. During 1979 and 1980, the government made several assessments against respondent for unpaid withholding and employment taxes that it concededly owed in the amount of approximately $92,000, plus interest. On January 14, 1981, the Internal Revenue Service, acting pursuant to Section 6331 of the Internal Revenue Code of 1954, levied upon property belonging to respondent. The levy was authorized by a warrant issued by a United States Magistrate. After entering respondent's place of business, the Service seized respondent's inventory, equipment, and other tangible property (App. A, *infra*, 1a-2a).

On the day following the Service's levy, respondent filed a petition for reorganization under Chapter 11 of the Bankruptcy Code and was continued as a debtor-in-possession. One month later, on February 18, 1981, the United States commenced an adversary proceeding in the United States Bankruptcy Court for the Western District of New York, seeking a determination that the automatic stay provision of the bankruptcy law (11 U.S.C. (Supp. IV) 362) was inapplicable to its proposed sale of the seized property, or, alternatively, that it be permitted to sell the property it had seized from respondent. The debtor counterclaimed, seeking an order requiring the United States to turn over the seized property to it pursuant to Section 542 of the Bankruptcy Code (App. A, *infra*, 1a-2a).

The bankruptcy court agreed with the government that under the law then applicable in the Western District of New York (see *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec.

(CRR) 210 (W.D.N.Y. 1981)) the debtor was not entitled to compel a turnover of the property under Section 542. In so holding, the bankruptcy court agreed with the government that only "property of the estate" — *i.e.*, interests in property belonging to the debtor at the time of the filing of the bankruptcy petition — is required to be turned over to a debtor pursuant to Section 542. Because the debtor had no right to have the property returned at the time the petition was filed, absent payment of the federal taxes, it had no such right in that property that would have been subject to a turnover order under that provision.

The bankruptcy court nevertheless ordered the government to turn over the seized property on the theory that the government was a "custodian" within the meaning of Section 543 of the Bankruptcy Code (11 U.S.C. (Supp. IV)), and thus was required by that Section to deliver to the trustee the "property of the debtor" under its control. However, the bankruptcy court conditioned turnover upon the debtor's payment to the government of $20,000 in order to protect the government's interests in the seized property (App. B, *infra*, 39a-43a).[1]

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[1] The $20,000 which the bankruptcy court ordered paid to the government as a condition of turnover included $15,000 contained in a bank account which the government had also seized by a pre-petition tax levy. Although the estimated worth of the seized property in the hands of respondent as a going concern was $162,876 (App. A, *infra*, 2a), the $20,000 payment was considerably less than the $35,000 that an expert witness estimated the government might be able to obtain upon a sale of the seized property. Accordingly, the government argued in the district court that the "protection" afforded by the bankruptcy court's order was not adequate. Because the district court sustained the government's contention that the debtor was not entitled to a turnover order, it did not reach this issue. The court of appeals, having concluded that turnover was authorized in a tax levy context, remanded the case with instructions to address and redetermine the issue of the adequacy of the protection before any new turnover order is issued.

On appeal, the district court upheld the government's position in all respects. It ruled that the government was not a "custodian" subject to the turnover provisions of Section 543 with respect to property seized by a tax levy executed before a bankruptcy petition is filed. Following its decision in *Avery Health Center*, *supra*, the district court likewise rejected the debtor's contention that the government could be compelled pursuant to Section 542 to turn over the seized property. The district court therefore reversed the order of the bankruptcy court requiring the government to deliver the property to the debtor (App. C, *infra*, 46a-51a).

The court of appeals reversed. Although it agreed with the district court that the government is not a "custodian" of property seized in a tax levy (App. A, *infra*, 7a-10a), it concluded that the government could be ordered to turn over such property under Section 542, provided the debtor could demonstrate that the government's interest in the property would be adequately protected (*id.* at 10a-32a).

In so holding, the court acknowledged that the question was a "close one," and that the only other court of appeals that had considered the question had reached a contrary conclusion. *Cross Electric Co.* v. *United States*, 664 F.2d 1218 (4th Cir. 1981). The court's review of the cases regarding the turnover authority of the bankruptcy courts, with respect to property held by certain private creditors, under Sections 257 and 507 of prior law (Act of June 22, 1938, ch. 575, 52 Stat. 902 and 927, 11 U.S.C. 657 and 907), and of the testimony before congressional committees during the hearings leading to the enactment of the Bankruptcy Code, led it to believe that Congress must have intended to incorporate in the new Bankruptcy Code the rule with respect to turnover authority that had developed in the decisions under the old Bankruptcy Act (App. A, *infra*, 12a-23a). Thus, despite the fact that this turnover authority had never been exercised under the prior law against the government in the context of a tax levy, the court of appeals concluded that the turnover authority under the new Bankruptcy Code extended to property seized by a federal tax levy (*id.* at 23a-31a). The court of appeals therefore remanded the

case to the bankruptcy court to "consider whether a turnover order is appropriate under present circumstances and, if it decides in the affirmative, what protection should be afforded to the United States" (App. A, *infra*, 32a).

REASONS FOR GRANTING THE PETITION

1. The decision of the court of appeals squarely conflicts with *Cross Electric Co.* v. *United States*, 664 F.2d 1218 (4th Cir. 1981). In *Cross Electric*, the Fourth Circuit held that a bankruptcy court had no authority to order the government to turn over to the debtor-in-possession property seized by a tax levy prior to the filing of a bankruptcy petition. The court pointed out that after the government's pre-bankruptcy tax levy, the debtor has only three rights—(1) the right to redeem the property, (2) the right to notice of sale, and (3) the right to any surplus proceeds generated by a tax sale. See Internal Revenue Code of 1954 (26 U.S.C.), Sections 6335(b), 6337(a) and 6342. Those limited rights do not include the right to the use or possession of the seized property, without payment of the taxes due. Since the applicable provision of the Bankruptcy Code (11 U.S.C. (Supp. IV) 541(a)(1)) specifies that only the "interests of the debtor in property as of the commencement of the case" become property of the estate, the Fourth Circuit ruled that property levied upon for taxes prior to bankruptcy is not subject to a turnover order under Section 542 of the Bankruptcy Code (664 F.2d at 1220-1221).

Here, by contrast, the court of appeals concluded that Congress must have intended to incorporate in the new Bankruptcy Code the substantive rule regarding turnover authority that had developed under case law interpreting Sections 257 and 507 of the prior Bankruptcy Act. While the court of appeals did not specifically interpret the new statutory provisions or indicate the scope of the authority it believed Congress intended to enact, it held that property seized by a pre-petition tax levy is subject to the turnover authority contained in the new Bankruptcy Code. The conflict in the circuits on this

important question requires resolution by this Court to establish a uniform national rule governing the relationship of the bankruptcy laws to the government's statutory authority to collect delinquent federal taxes.[2]

2. The decision below is contrary to the plain meaning of the relevant statutory provisions and Congress' intent in enacting the new Bankruptcy Code.

a. Section 542(a) of the Bankruptcy Code (App. D, *infra*, 54a) provides that property which the trustee may "use, sell, or lease," but which is out of the immediate possession of the

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[2] The lower courts are also divided on this issue. The decisions holding that turnover of property seized by a tax levy is not authorized include: *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec. (CRR) 210 (Bankr. W.D.N.Y. 1981); *Parker GMC Truck Sales, Inc.* v. *United States*, 6 Bankr. Ct. Dec. (CRR) 899 (Bankr. S.D. Ind. 1980); *Winfrey Structural Concrete Co.* v. *IRS*, 6 Bankr. Ct. Dec. (CRR) 695 (Bankr. D. Colo. 1980); *Bush Gardens, Inc.* v. *United States*, 5 Bankr. Ct. Dec. (CRR) 1023 (D.N.J. 1979); *In re Paukner*, 10 Bankr. 29 (Bankr. N.D. Ohio 1981); *Douglas* v. *United States*, 7 Bankr. Ct. Dec. (CRR) 690 (Bankr. D. Neb. 1981); *In re Bishop & Son, Inc.*, 81-2 U.S. Tax Cas. (CCH) ¶ 9555 (Bankr. W.D. Mo. 1981); *In re Cyber Electric Co.*, 49 A.F.T.R.2d (P-H) ¶ 82-520 (Bankr. E.D. Mich. 1982). The contrary decisions upholding turnover authority against the government include: *In re Aurora Cord & Cable Co.*, 2 Bankr. 342 (Bankr. N.D. Ill. 1980), aff'd, No. 80-C-396 (N.D. Ill. Dec. 1, 1981) (unpublished opinion); *Alpa Corp.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 791 (Bankr. D. Utah 1981), appeal pending, No. C81-0490J (D. Utah, filed July 2, 1981); *Bristol Convalescent Home, Inc.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 1151 (Bankr. D. Conn. 1981) (debtor, however, declined to afford adequate protection and thus turnover was never in fact ordered).

Two cases involving state, rather than federal, tax levies also hold that the seized property must be turned over for the debtor's use. *Troy Industrial Catering Service* v. *State of Michigan*, 2 Bankr. 521 (Bankr. E.D. Mich. 1980); *Barsky* v. *Commonwealth of Pennsylvania*, 6 Bankr. Ct. Dec. (CRR) 1216 (Bankr. E.D. Pa. 1981).

debtor, must be turned over to the trustee appointed to oversee the estate.[3] The provision states that—

> an entity * * * in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title * * * shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Section 363 states that the trustee may "use, sell, or lease" the "property of the estate."[4] Thus, Section 542 authorizes the turnover of "property of the estate."

In turn, for present purposes,[5] Section 541(a)(1) of the Bankruptcy Code defines "property of the estate" to include "all legal or equitable interests of the debtor in property *as of the*

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[3] In certain cases arising under Chapter 11 of the Bankruptcy Code, such as the instant case, the debtor remains in possession of the assets of the estate; the "debtor-in-possession" in such cases has all of the rights, powers and duties of a trustee. See 11 U.S.C. (Supp. IV) 1107(a).

[4] Section 363(b) of the Bankruptcy Code provides, in pertinent part, that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, *property of the estate*" (emphasis supplied). Similarly, Section 363(c)(1) provides, with exceptions not relevant here, that where the business of the debtor is authorized to be operated, the trustee may use "property of the estate" without notice or a hearing in the ordinary course of business.

[5] Other subsections of Section 541(a) (see Sections 541(a)(2) through (7)) specify that "property of the estate" includes additional property interests in which the debtor had no right as of the commencement of the case. For example, property of the estate includes property that a custodian must turn over pursuant to Section 543, property that the trustee recovers by using his avoiding powers (see Sections 544, 545, 547, 548 and 550), and other specified interests. See, *e.g.*, 11 U.S.C. 541(a)(3). The court of appeals did not rely upon any of these provisions.

commencement of the case" (emphasis supplied). Thus, the estate includes only the debtor's interests in property as of the date on which a petition is filed under the Bankruptcy Code. The debtor's interest in such property becomes "property of the estate" without regard to whether the debtor has title to the property or has possession of it. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 367-368 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 82-83 (1978).

Although the scope of Section 541(a)(1) is broad, it is not unlimited. The legislative history makes it clear that the provision was not intended to enlarge the debtor's rights in property.[6] Thus, the House and Senate Reports state that (H.R. Rep. No. 95-595, *supra*, at 367-368; S. Rep. No. 95-989, *supra*, at 82 (emphasis supplied))—

> [T]his paragraph [Section 541(a)(1)] * * * *is not intended to expand the debtor's rights against others more than they exist at the commencement of the case.* For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations,

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[6] Section 541 is somewhat broader than the predecessor provision (Section 70a of the Bankruptcy Act (Act of July 1, 1898, ch. 541, 30 Stat. 565, 11 U.S.C. 110(a)). Under the new provision, the debtor need not prove possession or constructive possession of the property in order to obtain its interests in the property for the benefit of the estate. That broader scope does not, however, expand the debtor's property interests.

After the case is commenced, in some circumstances the trustee may have different rights than the debtor would have had. For example, the trustee has an additional time period in which to pursue a claim, where the statute of limitations had not expired prior to filing the petition for relief under the Bankruptcy Code. See 11 U.S.C. (Supp. IV) 108; see also H.R. Rep. No. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82. Such exceptions to the general rule that the estate acquires whatever rights the debtor had are explicitly set forth in the Bankruptcy Code.

> then the trustee would not be able to pursue that claim, because he too would be barred. He could take *no greater rights than the debtor himself had.* * * *

The remarks of the principal congressional sponsors just prior to enactment are to the same effect. While acknowledging that Section 541(a) is an "all-embracing definition" which includes all "beneficial rights and interests" that the debtor may have, they nevertheless pointed out that (124 Cong. Rec. 32399, 33999 (1978) (emphasis added))—

> * * * *only the debtor's interest* in such property *becomes property of the estate.* If the debtor holds bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under Section 541.[7]

Thus, by virtue of Section 541(a)(1) the estate acquires only the debtor's interests in property. If the debtor's interests in property are limited, then the estate acquires only those limited

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[7] The legislative history contains numerous similar descriptions of Congress' intent. For example, Section 541(d) "reiterates the general principle that where the debtor holds bare legal title without any equitable interest, the estate acquires bare legal title without any equitable interest in the property." 124 Cong. Rec. 32399 (1978). The converse is also true (*ibid.*; emphasis added):

> Similarly, if the debtor holds an equitable interest in property without legal title, the estate would acquire only the equitable interest of the debtor in property and not the legal title. Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interest of the debtor in property as of the commencement of the case. *To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate* except to the extent that such defenses which are personal against the debtor are not effective against the estate.

See also, 4 *Collier on Bankruptcy* ¶ 541.24, at 541-88 (15th ed. 1979). Indeed, Congress' belief that this principle was clearly established resulted in its deletion of two provisions upon which it was based. The Senate had proposed that Section 541 expressly provide that property of the estate does not include amounts held by the debtor as

interests. 4 *Collier on Bankruptcy* ¶ 541.01, at 541-5 to 541-7 (15th ed. 1979). Accordingly, under the plain terms of the relevant statutory provision and the accompanying explanation set forth in the House and Senate reports, the "property of the estate" that a court may require to be turned over to the debtor-in-possession by virtue of Section 542(a) is its interests in property as of the date it filed its petition for relief pursuant to the Bankruptcy Code.

b. The Bankruptcy Code does not itself define the property interests of a debtor. That is a matter determined by reference to non-bankruptcy law. 4 *Collier*, *supra*, ¶ 541.02(1), at 541-10. Here, since the Internal Revenue Service seized the property sought by the debtor pursuant to a levy authorized by Section 6331 of the Internal Revenue Code to satisfy the debtor's federal tax liabilities, the interest of the debtor in the property must be determined by reference to the Internal Revenue Code.

The relevant provisions of the Internal Revenue Code make it clear that subsequent to a levy, the debtor's rights in the seized property are exceedingly limited. The debtor retains only the rights to "redeem" the property by paying the amount of tax due (Section 6337(a)), to receive notice of sale of the property (Section 6335(b)), and to obtain any surplus in the proceeds realized at sale (Section 6342). Since the debtor does not have the right prior to filing for reorganization to return of property seized for payment of taxes, unless he pays his arrearages in full, the debtor's estate does not obtain that right at the time of filing for reorganization. Accordingly, the debtor is not entitled pursuant to Section 542 to compel the turnover of property seized to satisfy the delinquent taxes. See *Cross Electric Co.* v. *United States*, *supra*, 664 F.2d at 1220-1221; *In*

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trustee or any taxes withheld or collected from others before the commencement of the case. These provisions were omitted as unnecessary since only the "legal and equitable interests of the debtor" become property of the estate. 124 Cong. Rec. 32147, 34016-34017 (1978).

re Avery Health Center, Inc., *supra*, 7 Bankr. Ct. Dec. at 212; *Parker GMC Truck Sales, Inc.* v. *United States*, 6 Bankr. Ct. Dec. (CRR) 899, 900 (Bankr. S.D. Ind. 1980).

c. Although the court of appeals found "some force" (App. A, *infra*, 12a) in the foregoing construction of the statutes, it concluded that it "ultimately must reject it" (*ibid.*). The court began its analysis by noting that in certain reorganization cases arising under prior law—specifically, under either Chapter X or XII of the Bankruptcy Act—a bankruptcy court had the authority to order secured creditors who had lawfully repossessed property of the debtor, but had not yet disposed of that property, to turn such property over the the reorganizing debtor. See Sections 257 and 507 of the Bankruptcy Act; *Reconstruction Finance Corporation* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950). The court of appeals observed that no specific provisions comparable to Sections 257 and 507 were enacted as part of the new Bankruptcy Code, and reasoned that if the Government's interpretation of Sections 363, 541, and 542 of the Code were adopted, the turnover power available in Chapters X and XII of prior law would not be available under the new Code. The court believed that Congress could not have intended such a result (App. A, *infra*, 12a-17a).

In reaching its conclusion that Congress intended to incorporate in the new Bankruptcy Code prior law with respect to turnover, the court relied upon the statements of certain witnesses before the congressional committees, urging that the turnover authority be made explicit in the new Bankruptcy Code. Noting that Congress added Section 542(a) to the proposed bill subsequent to this testimony, the court concluded that this sequence of events supported the inference that Congress intended Section 542(a) of the new Bankruptcy Code to codify the result under Sections 257 and 507 of the Bankruptcy Act (App. A, *infra*, 17a-23a).[8]

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[8] Sections 257 (in a Chapter X case) and 507 (Chapter XII) of the Bankruptcy Act specifically provided trustees with the right to "immediate possession of all property of the debtor in the possession of a

Finally, the court reasoned that because Section 542 was intended to authorize turnovers of repossessed collateral from secured creditors, such turnover authority should likewise exist with respect to property seized by a pre-petition tax levy. The court noted (App. A, *infra*, 25a) that the restrictions under prior bankruptcy law on the bankruptcy court's "summary" jurisdiction, which were in part the basis of the Court's decision in *Phelps* v. *United States*, 421 U.S. 330 (1975), no longer constituted an impediment to turnover authority under the new Code. The court of appeals believed that the government's position after a tax levy was indistinguishable from that of a creditor who has repossessed the debtor's property. Finding that the debtor in a tax levy situation is not divested of all "ownership" rights in the seized property, the court concluded that the debtor was as entitled to turnover of property seized to satisfy delinquent taxes as it was with respect to collateral in the possession of a secured creditor (App. A, *infra*, 26a-28a).

3. We submit the decision below is flatly at odds with the plain language of the relevant provisions of the Bankruptcy Code and the explanation of those provisions in the House and Senate reports. The court of appeals simply dismissed the government's reading of the plain terms of the statute as "mechanical" (App. A, *infra*, 12a), and instead supplied the result it believed Congress must have intended. But a court's first duty in interpreting a statute is to look to the terms employed in a statutory provision where the terms are plain and that method produces a reasonable result. See, *e.g.*, *Commissioner* v. *Brown*, 380 U.S. 563, 571 (1965); *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102,

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trustee under a trust deed or a mortgagee under a mortgage." A line of cases including *Reconstruction Finance Corporation* (see App. A, *infra*, 15a) extended this turnover authority in Chapters X and XII proceedings to certain other types of "property of the debtor" thought to be analogous to the property interests described in the statutory provisions.

108 (1980); *Middlesex County Sewerage Authority* v. *National Sea Clammers Association*, 453 U.S. 1, 13 (1981); *Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *Howe* v. *Smith*, 452 U.S. 473, 480, 483 (1981); *United States* v. *Turkette*, 452 U.S. 576, 580 (1981). Moreover, when resort to legislative history is necessary to determine the meaning of an ambiguous statutory provision, it is well established that the text of the final House and Senate committee reports explaining the measure, as well as the explanatory remarks concerning the legislation made by the chief sponsors thereof just prior to final passage, are of primary value. *United States* v. *Automobile Workers*, 352 U.S. 567, 585 (1957); *NLRB* v. *Fruit Warehousemen*, 377 U.S. 58, 66 (1964).

The court of appeals gave no weight to the explanations in those primary legislative sources. Rather, the court rested its conclusion largely upon its belief that Congress intended to retain prior law regarding turnover, despite Congress' failure to employ terms accomplishing that end or to make its desire to do so explicit in the House and Senate committee reports. Finally, the court relied upon the statements and proposals of witnesses in hearings before congressional committees, even though the proposals and suggested terms were not employed in the statute that Congress ultimately enacted.[9]

Finally, the court's statutory interpretation cannot be reconciled with the explanation set forth in the reports of the House and Senate committees responsible for reporting out

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[9] For example, the court cited certain testimony, as well as a proposal submitted by the National Bankruptcy Conference, which requested Congress to add a section to the proposed new Code explicitly succeeding Sections 257 and 507 of the Bankruptcy Act (App. A, *infra*, 19a-21a). Congress declined, however, to enact the cited proposal. Under the National Bankruptcy Conference proposal, "custodians" and "creditors in possession" would have been required to turn over "property of the debtor" in their possession. See App. A, *infra*, 21a n.16. The terms of the proposal are similar to the terms eventually enacted in Section 543, governing turnover of property by custodians. And the court of appeals held that the Internal

the legislation (see pages 8-9, *supra*). For example, the court of appeals stated (App. A, *infra*, 29a) that its ruling is "entirely consistent" with Congress' intent that Section 541(a)(1) would not expand the trustee's rights beyond those of the debtor at the commencement of the case.

But that is simply not the case. As we have pointed out (page 10, *supra*), at the time the debtor filed its petition, it did not have any right to obtain the seized property, absent full payment of its tax liability. The court, however, expanded the rights of the debtor in reorganization beyond those it had prior to the filing of its petition—a result plainly inconsistent with the explanations of the House and Senate committee reports.

4. The court of appeals therefore erred in concluding that Congress intended to incorporate in Section 542 of the new Bankruptcy Code a "rule" unexpressed by Congress that had developed (the court assumed) under case law interpreting Section 257 of the Bankruptcy Act.[10] But even on the assumption that the court's conclusion in this respect was sound, the court nevertheless erred in extending such turnover authority to reach property seized by a pre-petition tax levy.

The essence of the court's theory is that the turnover authority in Chapters X and XII proceedings under the Bankruptcy Act was such a crucial tool of reorganizing debtors that Congress could not be thought to have omitted that authority under the new Code, without some affirmative indication that

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Revenue Service is not a "custodian" of property seized in a levy within the meaning of Section 543(a) (App. A, *infra*, 10a). But insofar as entities other than custodians are concerned, Congress enacted a very different provision. Section 542(a), through its reference to Section 363, provides for turnover only of "property of the estate."

[10] The court of appeals acknowleged (App. A, *infra*, 15a), however, the scope of that turnover authority was regarded as unsettled under prior bankruptcy law. See, *e.g.*, Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 15, 39 (1974).

it was doing so. That reasoning, however, provides no justification for establishing a substantive rule of law requiring the turnover of property seized prior to bankruptcy to satisfy the debtor's delinquent tax liabilities. Under prior law, property seized by a pre-petition tax levy was not subject to turnover authority either in liquidating bankruptcies (*Phelps* v. *United States, supra)* or in reorganization proceedings (*In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979)).[11]

Thus, while the court of appeals expressed the view (App. A, *infra*, 16a) that it should avoid declaring a major change in the law without some unambiguous indication that Congress so intended, that is precisely the course it followed in this case. In holding that the Internal Revenue Service is subject to turnover orders for property seized pursuant to levy prior to bankruptcy, the court has in fact made a drastic change in the law concerning collection of taxes, without any explicit indication in the legislative history that Congress in fact intended so substantially to alter the long-accepted status of government tax levies. Significantly, the Senate Finance Committee Report, which summarized the tax aspects of the proposed legislation, did not mention any intended change from prior law with respect to turnover authority in the context of a tax levy. S. Rep. No. 95-1106, 95th Cong., 2d Sess. (1978). As this Court has stated, "[i]t will not be inferred that the legislature, in revising and consolidating the laws, intended to change their policy, unless such intention be clearly expressed." *United States* v. *Ryder*, 110 U.S. 729, 740 (1884). Accord: *Aberdeen & R.R.R.* v. *Students Challenging Regulatory Agency Procedures*, 422 U.S. 289, 309 n.12 (1975); *Muniz* v. *Hoffman*, 422 U.S. 454, 467-472 (1975); *Fourco Glass Co.* v. *Transmirra Products Corporation*, 353 U.S. 222, 227 (1957).

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[11] Although *Pittsburgh Penguins* arose under Chapter XI of the Bankruptcy Act, no case holds that such turnover activity existed in a tax levy context under either of the other two reorganization chapters, Chapters X and XII.

In sum, whether or not Congress by implication incorporated previously existing turnover authority in the new Bankruptcy Code, the decision below erred in extending such authority to destroy the efficacy of federal tax levies.[12] Such a fundamental change in the bankruptcy law as it affects the government's authority to collect delinquent taxes calls for review by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1982

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[12] The legislative history indicates that "trust fund" taxes are not "property of the estate," even where the collected taxes are in the possession of the debtor when the petition is filed. 124 Cong. Rec. 32147, 34016-34017 (1978). Hence, the withheld taxes still in the debtor's possession would not be property available for the debtor's use. Ironically, however, under the court of appeals' decision, when the government has taken active steps to collect by levy delinquent amounts due for such withholding taxes, the court would require that the seized property be returned to the debtor for its use.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 441—August Term, 1981
(Argued: December 3, 1981 Decided: March 9, 1982)
Docket No. 81-5046

UNITED STATES OF, AMERICA,
Plaintiff-Appellee,

—against—

WHITING POOLS, INC.,
Defendant-Appellant.

Before

FRIENDLY, OAKES AND PIERCE,
Circuit Judges.

FRIENDLY, *Circuit Judge:*

The question on this appeal is whether a debtor in possession under Chapter 11 of the Bankruptcy Code of 1978 is entitled to an order, under §§ 542 or 543 of the Code, requiring the Internal Revenue Service (IRS) to turn over tangible assets of the debtor on which the IRS had levied pursuant to § 6331 *et seq.* of the Internal Revenue Code (IRC). This question has created much conflict among bankruptcy judges and district courts throughout the nation. [1] The only other court of appeals

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[1] Decisions of bankruptcy and district courts denying the turnover power include; *In re Avery Health Center, Inc.*, 8 B.R. 1016 (W.D.N.Y. 1981); *In re Paukner*, 10 B.R. 29 (Bankr. Ct. N.D. Ohio 1981); *In re Douglas*, 10 B.R. 283 (Bankr. Ct. Neb. 1981); *In re Bishop & Son, Inc.*, 81-2 U.S.T.C. ¶ 9555 (Bankr. Ct. W.D. Mo. 1981); *In re Birco Mining Co.*, 10 B.R. 545 (Bankr. Ct. N.D. Ala.

that has considered the issue has answered it in the negative, *Cross Electric, Inc.* v. *United States*, No. 81-1111, slip op. (4 Cir. November 24, 1981). The issue is of importance to the successful reorganization of debtors, on the one hand, and to the interest of the United States in the quick collection of tax revenues, on the other. We find the issue more difficult than did the Court of Appeals for the Fourth Circuit and, conceding the question to be a close one, reach an opposite result.

Whiting Pools, Inc. (Whiting), the debtor, was in the business of selling, installing and servicing swimming pool equipment and supplies. On January 14, 1981, the IRS, acting pursuant to IRC § 6331, seized all of Whiting's tangible property, including equipment, vehicles, inventory, office equipment and supplies, at its place of business in the Western District of New York. The estimated worth of the seized property in the hands of Whiting as a going concern was $162,876. The lien of the IRS was for some $92,000, plus interest, in unpaid withholding and Federal Insurance Contributions Act taxes. Testimony taken before the bankruptcy judge indicated that sale of the property by the IRS would net a maximum of $30,000 to $35,000, with a more probable recover in the neighborhood of $20,000.

On the day following the IRS levy Whiting filed a petition under Chapter 11 of the Bankruptcy Code and was continued

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1981); *Parker GMC Truck Sales, Inc.* v. *United States*, 6 B.C.D. 899 (Bankr. Ct. S.D. Ind. 1980); *In re Winfrey Structural Concrete Co.* v. *I.R.S.*, 6 B.C.D. 695 (Bankr. Ct. D. Col. 1980); and *Bush Gardens, Inc.* v. *United States*, 10 B.R. 506 (Bankr. Ct. D.N.J. 1979).

Decisions of bankruptcy and district courts upholding the power include: *In re Alpa Corp.*, 11 B.R. 281 (Bankr. Ct. D. Utah 1981), *appeal pending*. (D. Utah); *In re Bristol Convalescent Home, Inc.*, 7 B.C.D. 1151 (Bankr. Ct. D. Conn. 1981); *In re Aurora Cord & Cable Co.*, 2 B.R. 342 (Bankr. Ct. N.D. Ill. 1980), *appeal pending*, (N.D. Ill.); *Troy Indus. Catering Service* v. *Michigan*, 2 B.R. 521 (Bankr. Ct. E.D. Mich. 1980) (state tax levy); *In re Barsky*, 6 B.C.D. 1216 (Bankr. Ct. E.D. Pa. 1980).

as a debtor in possession, § 1101(1). A month later the United States initiated an adversary proceeding under § 362(d) of the Code in which it sought a determination that the automatic stay provisions of § 362 were inapplicable to it or, in the alternative, for relief from the stay to permit it to sell the property. It alleged that storing the property was costing $2,500 per month. Whiting's answer contained a counterclaim asking that the IRS be required to turn over the property pursuant to § 542 of the Bankruptcy Code.

Bankruptcy Judge Hayes, after holding hearings, delivered an opinion, 10 B.R. 755 (Bankr. Ct. W.D.N.Y. 1981), in which he concluded that the automatic stay provided in § 362 was applicable to the IRS—a conclusion which is not disputed here. Examining § 362(d), which directs the bankruptcy court to grant relief from such a stay under certain circumstances, [2] the judge found that such relief could be be granted under § 362(d)(2) since the debtor had an equity in the property and the property was "absolutely necessary to an effective reorganization of the debtor." *Id.* at 757. Turning back to § 362(d)(1), the judge concluded that while the best interests of the United States would be served by a reorganization, for which he thought there was a reasonable chance, and the Government could be adequately protected while the reorganization proceeding was pending, it made "little sense to continue the stay unless a turnover of property", *id.*, could

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[2] These are:

§ 362(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property, if—

(A) the debtor does not have an equity in such property and

(B) such property is not necessary to an effective reorganization.

lawfully be directed. He thus reached what both parties concede to be the crucial issue, namely, whether it could be.

We set forth in the margin the sections of the Bankruptcy Code which must be construed in deciding that question. [3]

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§ 361. Adequate protection—

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entitity in property, such adequate protection may be provided by—

(1) requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowance under section 503(b)(1) of this title as an administrative expenses, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property. § 363(b) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents: or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

Although Whiting had sought a turnover under § 542, the bankruptcy judge was precluded from granting relief under that section by the decision of District Judge Elfvin in the Western District of New York in *In re Avery Health Center*,

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(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any case collateral in the trustee's possession, custody, or control.

* * *

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

§ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of this case.

§ 542(a) Except as provided in subsection (c) or (d) of this section, and entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for

Inc., 8 B.R. 1016 (W.D.N.Y. 1981), with which he seemingly disagreed. Believing that the turnover power formerly provided in proceedings under Chapter X of the Bankruptcy Act by the last sentence of § 257, [4] see *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791, 795 (1 Cir. 1950), must have gone somewhere, he found them in § 543(b), reading the defini-

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such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

§ 543(b) A custodian shall—

(1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of this case: and

(2) file an accounting of any property of the debtor, or proceeds of such property, that, at any time, came into the possession, custody, or control of such custodian.

§ 101(10) "custodian" means—

(A) receiver or trustee of any of the property of the debtor, apppointed in a case or proceeding not under this title:

(B) assignee under a general assignment for the benefit of the debtor's creditors: or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

[4] Section 257 provided:

The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.

tion of "custodian" in § 101(10), more particularly the reference to an "agent", as including the IRS, 10 B.R. at 759. After noting the anomaly that §543 seems to permit a turnover without providing for the protection that would be required by reading §§ 363(e) and 542 together, he directed the turnover on the conditions set forth in the margin. [5]

The district court reversed. It adhered to its previous decision in *In re Avery Health Center, Inc., supra*, concerning § 542, and rejected the bankruptcy judge's theory that the IRS was an "agent" under § 101(10)(C) and thus a "custodian" under § 543. It considered that "the concept of agency entails a fiduciary relationship arising out of an express or implied contract between the principal and the agent," and that the IRS, when making a levy under IRC § 6331, did not fill such a role. The court remanded the case to the bankruptcy court to determine whether the stay of the IRS's proposed sale should be lifted. Whiting appealed to this court, and the bankruptcy court declined to take action upon the remand pending our decision.

I. *Section 543*

The definition of "custodian" in § 101(10) finds an antecedent in § 2a(21) of the former Bankruptcy Act, which required, under certain circumstances, delivery of property by "receivers or trustees appointed in proceedings not under this Act,

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[5] (1) That the debtor-in-possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and

(2) That the debtor shall pay to IRS the sum of $1,000 a month until the tax is paid, and

(3) That during this period of time IRS shall retain its lien upon the property seized, and

(4) That if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted. . . ."

assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property." The definition of custodian in § 101(10) appears in H.R. 8200, 95th Cong., 1st Sess., as reported by the House Committee on the Judiciary on September 8, 1977, H.R. Rep. No. 95-595, with a comment which we reproduce in the margin. [6] The same definition and comment can be found in S. 2266, 95th Cong. 2d Sess. and in S. Rep. No. 95-989 p. 23. These shed little light on the meaning of the phrase "or agent under applicable law, or under a contract" etc.

Since § 101(10)(A) and (B) include two of the categories described in § 2a(21) of the previous Act, § 101(10)(C) must have been intended to include and possibly broaden what had been covered by § 2a(21)'s phrase, "agents authorized to take possession of or to liquidate a person's property". Seemingly it embraces the case of an agent appointed or authorized by a debtor to take charge of property for the purpose of enforcing a lien of a particular creditor, but see, *contra*, *In re Lewis*. 12 B.R. 106, 108-09 (Bankr. Ct. M.D. Ga. 1981), which may not have been true under § 2a(21) of the previous Act. *Compare* 1 Collier on Bankruptcy ¶ 2.78, at 390.23 n.35 (14th ed.) *with In re Rosenberg*, 128 F.2d 924 (7 Cir. 1942).

Here there is no doubt that the IRS is "authorized to take charge of property of the debtor for the purpose of enforcing a lien against . . . property" of the debtor. However, the definition of "custodian" does not include anyone who is so authorized but only a person who acts as a trustee, receiver, or

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[6] Paragraph (10) defines "custodian." There is no similar definition in current law. It is defined to facilitate drafting, and means prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or a liquidator or administrator of the debtor's property. The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles. The definition is intended to include other officers of the court if their functions are substantially similar to those of a receiver or trustee.

agent. Admittedly the IRS is not a trustee or receiver. No one would characterize it as the taxpayer's agent as a matter of ordinary English speech. The Restatement of Agency 2d, § 1 (1958) defines agency as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." See also Restatement of Agency 2d § 1, Comment, at pp. 8-9 (1958). Seizure of property by the IRS under IRC § 6331 is not pursuant to a consensual relationship but is imposed by law irrespective of and generally contrary to the taxpayer's desires. It is true that a person may be an agent under § 101(10)(C) when the relationship is created by law rather than by contract, but it would be a strained reading to interpret this as including the IRS, the archetypical "adverse claimant", see *Phelps* v. *United States*, 421 U.S. 330, 334 (1975). [7] It is thus immaterial that the IRS has certain

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[7] The bankruptcy judge and Whiting seek to draw support for the conclusion that the IRS is a "custodian" under § 543 [illegible] in cases arising under Chapter X of the Bankruptcy Act, most notably *RFC* v. *Kaplan*, 185 F.2d 791 (1 Cir. 1950) (Magruder, C.J.), which held that a creditor who had taken possession of a debtor's goods after default could be required to turn over the goods to a trustee or a debtor in possession. Apart from the fact that the origin of the creditor's possession lay in a consensual transaction, these cases, as is developed below, went not on the ground that the creditor was acting as the debtor's agent but on the basis that § 111 of the Bankruptcy Act gave the reorganization court "exclusive jurisdiction of the debtor and its property wherever located", differing in this respect from ordinary bankruptcy in which the bankruptcy court had jurisdiction only over property in the bankrupt's possession and the trustee was obliged to institute a plenary suit to recover other property. See *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2 Cir.), *cert. denied*, 296 U.S. 584 (1935).

Several bankruptcy courts have held that an ordinary secured creditor in possession is a "custodian" under the Code, and therefore subject to § 543's turnover requirement, *Smitty's Inc.* v. *Southeast National Bank*, 1 C.B.C. 2d 366 (Bankr. Ct. M.D. Fla. 1979) (writ of

responsibilities, such as giving notice of seizure and sale and accounting for any surplus.

Beyond this, in determining the meaning of "custodian" as used in § 543, it is necessary to consider the other provisions of the Code. One of these is § 543(c), which requires the bankruptcy court to provide a custodian with "reasonable compensation for services rendered and costs and expenses incurred." We can think of no reason why Congress would have chosen to provide the IRS with reasonable compensation, as distinguished from reimbursement of expenses, see IRC § 6342(a)(1), for its efforts to dismember the debtor's estate in its own interest. Moreover, as Bankruptcy Judge Hayes noted below, 10 B.R. at 760, § 542's explicit reference to § 363, and thereby to the adequate protection requirements of § 361, suggests that § 542 is a "more appropriate section", 10 B.R. at 760, than § 543 for resolving turnover disputes involving secured creditors.

We therefore conclude that the district judge correctly decided that § 543 afforded no basis for a turnover order, and must consider whether he was also correct in his earlier ruling in *In re Avery Health Center, Inc., supra*, 8 B.R. 1016, to which he adhered in this case, that no basis was furnished by § 542.

II. *Section 542—Turnover Generally*

Determination whether § 542 is here applicable requires consideration of several sections of the Code. Section 542 requires the turnover "of property that the trustee may use, sell

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replevin); *In re Gunder*, 8 B.R. 390, 394 (Bankr. Ct. S.D. Ohio 1980) (repossession); *In re Brickel*, 11 B.R. 353, 355 (Bankr. Ct. D. Me. 1981) (repossession); *In re Williams*, 6 B.R. 789 (Bankr. Ct. E.D. Mich. 1980) (repossession). Apart from the fact that the ultimate source of the creditor's right in these decisions was a consensual transaction, we find little analysis which assists us. We express no view on their correctness.

or lease under section 363. . . ." Section 363(c)(1) directs that in a Chapter 11 proceeding the trustee, without notice or a hearing, may use, sell or lease "property of the estate" in the ordinary course of business, but § 363(e) requires that "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." Section 541(a)(1) provides that, with exceptions not here relevant, an estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case."

The Government argues that the plain meaning of these sections mandates an answer in its favor. Relying on several decisions in the district and bankruptcy courts, see footnote 1, *supra*, the Government finds in § 541's definition of "property of the estate" a distinction between a debtor's *interests in property* and *property in which the debtor has an interest*. The Government, Brief at 17, then advances the following general interpretation of the Code's turnover provision: "the 'property of the estate' which must be delivered to the trustee . . . by virtue of Section 542(a) consists only of any interests in property belonging to the debtor as of the time of its filing of a petition" in bankruptcy. The Government concludes that; at the commencement of the case, the debtor's only interests in the property seized by the IRS were those explicitly set forth in § 6331 *et seq.* of the IRC, [8] that therefore only these interests became part of the "property of the estate", and that turnover of these interests would be inappropriate since the debtor cannot "use, sell, or lease" them. Brief at 7, 18-19. All other interests in the seized property, in particular the right to

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[8] According to the Government, these were: a right to notice of the seizure and the sale, § 6335(a) and (b); a right to redemption prior to the sale, § 6337(a), and, in the case of real property, for 120 days thereafter, § 6337(b); and a right to surplus proceeds, § 6342(b).

possession, are argued to be held by the IRS. The Government draws on several general statements in the Code's legislative history to support its contention. [9]

Although there is some force in the Government's construction of §§ 542, 541 and 363, we ultimately must reject it. Justice Cardozo, interpreting one of the predecessors of the Code in *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U.S. 216, 218 (1936), said, "To fix the meaning of these provisions there is need to keep in view the background of their history. There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts." The mechanical interpretation of § 541(a)(1) urged by the Government would require us to violate admonition. [10]

The Government's general interpretation of the interplay of § 542 and § 541(a)(1)'s definition of "property of the estate" would have a far-reaching effect on reorganizations by denying to debtors or trustees in reorganization not only the power to

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[9] For example, the Government directs our attention to the following remarks by Representative Edwards:

> [O]nly the debtor's interest in such property becomes property of the estate. If the debtor holds bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under section 541.

124 Cong. Rec. H 11,096 (Sept. 28, 1978), *reprinted in* [1978] U.S. Code Cong. & Ad. News 6455.

[10] Indeed, the immediate legislative history contains language inconsistent with the rigid reading of "property of the estate" urged by the Government. The House Report accompanying the Bankruptcy Code, after noting that the "scope of [§ 541(a)(1)] is broad", states that property of the estate "includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act section 70a(6) and all other forms of property currently specified in section 70a of the Bankruptcy Act § 70a, as well as property recovered by the trustee under section 542 of proposed title 11, if the property recovered was merely out of the possession of the debtor,

obtain the turnover of property of the debtor levied upon by the IRS, but also that repossessed prior to bankruptcy by secured creditors or held by pledgees after a default. In all these instances the secured creditor would have rightful possession of the property. Typical statutes recognize the debtor as having only limited "rights" in the property—notice of sale, redemption prior to sale, and receipt of surplus proceeds, see pp. 18-19 *infra* and not 8 *supra*. Thus, under the Government's reading of the statute, only these limited *interests in property* would constitute "property of the estate". The trustee therefore could obtain turnover only of these interests, which he has without benefit of a turnover order, not the property itself.

The results dictated by the Government's interpretation of § 542 would be a significant departure from the treatment of reorganization proceedings under the former Bankruptcy Act. In Chapter X reorganization cases under that Act a bankruptcy court had broad power to order secured creditors in possession following the debtor's default to turn over their collateral. In the leading case of *Reconstruction Finance Corporation* v. *Kaplan*, 185 F.2d 791 (1 Cir. 1950), a pledgee seized the debtor's plant, equipment and inventory following default on a loan, thereby precipitating the filing of a Chapter X reorganization petition later in the day. Following approval of the debtor's reorganization plan, the bankruptcy court ordered the pledgee to turn over the repossessed property to the debtor's trustee. The First Circuit, speaking through Chief Judge Magruder, upheld the order, on the ground that such

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yet remained 'property of the debtor'". Report of the Committee on the Judiciary, House of Representatives, To Accompany H.R. 8200, H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 367 (1977). This discussion indicates that § 541(a)(1) was not intended to narrow the old Act's definition of "property of the estate", as the Government's reading of the statute would require, but rather to preserve or enlarge it.

authority was necessary if Chapter X reorganizations were to have a realistic possibility for success:

> In contrast with the provisions of law relating to straight bankruptcy, Chapter X, like its earlier counterpart § 77B, . . . contemplates the rehabilitation of financially ailing business corporations under plans of reorganization which may deal with claims of creditors, secured as well as unsecured, and embrace all of the debtor's property, however encumbered with outstanding security interests. In keeping with this objective, appropriate broad powers are conferred upon the reorganization court.

185 F.2d at 794.

The court also wrote that:

> The second sentence of § 257 may not specifically authorize a turnover order displacing the ordinary possessory lien of a pledgee of collateral or other personal property; but it seems in substance to cover the kind of security interest which RFC had in the inventory under its statutory factor's lien. In other words, RFC's lien on the inventory had the characteristic of a chattel mortgage, with possession, and the right to possession, remaining in the borrower until default. *But there is no need to rest on the second sentence of § 257, which is not the broad basic section conferring upon the court jurisdiction over all the debtor's property wherever located;* it appears rather to be a specific provision inserted out of abundance of caution to make clear the inapplicability under Chapter X of Tuttle v. Harris, 1936, 297 U.S. 225, a case decided under § 77B. (Emphasis added.)

Id. at 795. [11]

The First Circuit's conclusion in *RFC* v. *Kaplan*, *supra*, was also reached in a number of other cases, some proceeding and

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[11] The fears of Congress with respect to Tuttle v. Harris, 297 U.S. 225 (1936), may well have been exaggerated. The holding in that case simply echoed that in *Duparquet*, supra, 297 U.S. 216, that appointment of a foreclosure [receiver was not an event that would authorize the commencement of a 77B] proceeding under § 77B(i). It did not deal with the power of the bankruptcy court to order a turnover by such a receiver when a 77B proceeding had been properly instituted.

others following it. See *Grand Boulevard Investment Co.* v. *Strauss*, 78 F.2d 180 (8 Cir. 1935) (under § 77B); *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2 Cir.) (under ⅞ 77B), *cert. denied*, 296 U.S. 584 (1935); *John Hancock Mutual Life Insurance Co.* v. *Casey*, 134 F.2d 162 (1 Cir.) (per curiam), *cert. denied*, 319 U.S. 757 (1943); *In re Franklin Garden Apartments, Inc.*, 124 F.2d 451 (2 Cir. 1941); *In re Third Avenue Transit Co.*, 198 F.2d 703, 706 (2 Cir. 1952) (affirming bankruptcy court's authority to order turnover, but refusing to exercise discretion to do so). See also 6A Collier ¶ 14.03, at 741 (14th ed. 1977). The validity of Chief Judge Magruder's observation that this power of the bankruptcy court to order the turnover of property in the lawful possession of secured creditors did not depend solely on § 257 is demonstrated by the fact that two of these decisions were rendered under § 77B, the predecessor of Chapter X which included § 257. A principal basis of these decisions was that the reorganization statutes, § 77B(a), § 111 (Chapter X) and § 411 (Chapter XII), unlike the provisions applying in ordinary bankruptcy, but like § 77(a), see *Continental Illinois National Bank & Trust Co.* v. *Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935), gave the bankruptcy court jurisdiction of all the property of the debtor, whether or not it was in the debtor's possession. [12]

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[12] There was some uncertainty as to the scope of the bankruptcy court's turnover power in Chapter XI proceedings under the former Act. According to one commentator:

> Probably the single greatest area of uncertainty with respect to the exercise of Chapter XI jurisdiction concerns the secured creditor in possession of property of the debtor. It is at present unclear whether the court has the power to prevent a secured creditor in possession from enforcing its lien and whether the court has the power to force that creditor to surrender property to the debtor.

Murphy, Restraint and Reimbursement: *The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 15, 39(1974). A number of recent decisions affirmed a turnover power in Chapter XI cases similar to that under Chapter X and XII, e.g., *In re*

The Government's reading of § 541 would have the effect of reversing this settled law in reorganization proceedings under Chapter 11 of the Code. We see no evidence that any such drastic change was intended. As Justice Douglas put it, in interpreting the old Bankruptcy Act in *Emil* v. *Hanley*, 318 U.S. 515, 521 (1943), "We cannot help but think that if Congress had set out to make such a major change, some clear and unambiguous indication of that purpose would appear." We find no such indicaton in the new Code or its legislative history. And, like Justice Douglas, we do not believe that nearly fifty years of the law of reorganization under the Bankruptcy Act would have been changed without some clear statement to that effect. This is particularly true because the Government's reading of the Bankruptcy Code would seriously affect the chances of success in many reorganizations: "It is . . . generally vital to the success of a reorganization that all the debtor's property be included, that the continuation of the debtor's business be not unduly hampered by dissipation of the proper-

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George W. Schultz, 50 Am. Bankr. L.J. 185 (Bankr. Ct. D. Okla. 1975); *In re Roebling Steel & Wire Corp.*, 1 B.C.D. 944 (Bankr. Ct. D.N.J. 1975); *In re American Kitchen Foods. Inc.* 2 B.C.D. 715 (D. Me. 1976). there was, however, authority for the proposition that, since arrangements of unsecured debts under Chapter XI, unlike proceedings under Chapters X and XII, see *In re Colonial Realty Investment Co.*, 516 F.2d 154 (1 Cir. 1975), were not intended to alter the rights of secured creditors, a narrower turnover power was appropriate in Chapter XI, 8 Collier on Bankruptcy ¶ 3.02, at 156-63 (14th ed. 1977). A version of this latter view was accepted in *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3 Cir. 1979), where the court held that in a Chapter XI proceeding the IRS could not be compelled to turn over property on which it had levied prior to the filing of a petition in bankruptcy. This decision is of little guidance in the present reorganization proceeding, both because the Third Circuit was of the view that the bankruptcy court's turnover power was extremely limited in Chapter XI cases, and because it thought that certain language in *United States* v. *Phelps*, *supra*, was dispositive of the case before it, a view we do not share, see pp. 23-24, infra.

ty to particular creditors. . . ." 6 Collier on Bankruptcy ¶ 3.05, at 431 (14th ed. 1977). In light of legislative history indicating that reorganizations were to be encouraged under the new Code, we doubt that Congress intended such a result. [13]

Indeed an examination of the legislative history antedating 1977 compels a broad view of § 542's turnover power. Section 542 was a relatively late addition to the Code. It did not appear in the early drafts of the proposed legislation, [14] and was first included in H.R. 6, which was introduced on Jan. 4, 1977.

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[13] See the remarks of Representative Edwards quoted in text at pp. 25-26, *infra*. According to Chairman Rodino, of the House Judiciary Committee. "[f]or business, the bill facilitates reorganizations, protecting investments, and jobs." 123 Cong. Rec. H. 11,697 (daily ed. Oct. 27, 1977).

[14] By early we mean H.R. 10,792, introduced Oct 4, 1973; S. 2565, introduced Oct. 11, 1973; H.R. 16,643, introduced Sept. 12, 1974; H.R. 31; H.R. 32; S. 235; and S. 236. See Klee, Legislative History of the New Bankruptcy Code, 54 Am. Bankr. L.J. 275, 280 (1980).

> The provision that came the closest to creating a general turnover power was § 4-603, which was a "custodian" turnover section similar to what is now § 543; Sec. 4-603. EFFECT OF FILING OF PETITION ON PRIOR CUSTODIAN OF DEBTOR'S PROPERTY.—
>
> (a) APPLICABILITY OF SECTION.—If when a petition is filed under this title the property of the debtor is in the possession of —
>
> (1) a receiver, trustee, or other officer of a nonbankruptcy court, or
> (2) an assignee under a general assignment for the benefit of creditors, or
> (3) a trustee or agent under a statute or contract who is appointed or authorized to take charge of the property of the debtor or of a general administration of the debtor's property for the benefit of creditors,
>
> the custodian's rights and duties respecting the property shall be governed by this section.
>
> (b) DUTY OF CUSTODIAN TO DELIVER PROPERTY AND MAKE ACCOUNTING.—A custodian of the debtor's property to whom this section applies shall deliver the property in his possession to the trustee of the debtor's estate under this title

H.R. 6 was the product of the House Judiciary Committee, which prepared the bill after the Subcommittee on Civil and Constitutional Rights had conducted extensive hearings on earlier drafts. [15] H.R. 6 was prepared with the intent of resolving problems that had been identified during these hearings. 124 Cong. Rec. H 11690, 11701; Klee, *Legislative History of the New Bankruptcy Code*, 54 Am. Bankr. L.J. 275, 280 (1980). Since § 542 first appeared in H.R. 6, it is important to consider what was said at those hearings regarding the turnover of collateral from secured creditors in possession.

The House and Senate subcommittee hearings contain a number of statements regarding the bankruptcy court's turnover power. The following pattern emerges from the testimony: Witnesses said it was clear that the bankruptcy courts were intended to have (and should have) the authority to order the turnover of collateral from secured creditors in possession. Concern was expressed, however, that the language of early drafts of the proposed legislation failed to set forth the basis for such a turnover power in sufficiently explicit detail; consequently, redrafting of the legislation on this point was urged. Witnesses also suggested that turnover be preceded by the provision of adequate protection for secured creditor's interests. We are not aware that any witness opposed a broad turnover power if this was accompanied by proper provisions for protection.

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and shall account to the administrator for the disposition of the property received as such custodian unless—

(1) the prior custodian took possession of the property for the purpose of general administration of the debtor's estate more than three months prior to the filing of a petition for relief under chapter V of this title: . . .

H.R. 31, § 4-603. H.R. 32, S. 235, and S.236 all contained almost identical provisions.

[15] The House hearings involved some 100 witness, whose testimony fills some 2,800 pages plus appendices.

The following excerpts from the congressional hearings illustrate the above summary. One witness told the House subcommittee:

> I believe that it is almost beyond argument that in the new bankruptcy legislation collateral in the possession of secured creditors should be subject to the jurisdiction of the bankruptcy court, except, perhaps, where the bankruptcy is directed toward liquidation and the property has already been taken into custody by another court of competent jurisdiction. . . .
>
> In rehabilitative proceedings it is proper for the court to be able to control under the injunctive power liquidation procedures by secured creditors in possession *and under adequate safeguards to compel the surrender of collateral for use in the rehabilitation process. While recognizing the wish of this Committee that witnesses not comment on the specific language of the proposed legislation at this time I note that the power of the court to compel the surrender of collateral has been left largely to inference in both of the Bills presently before Congress. Leaving this issue to case by case development is, in my opinion, undesirable in light of the present judicial uncertainty on the point and I believe that the legislation should expressly deal with the question of when and under what standards displacement of the secured creditor or its agent should be permitted.*

Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, Bankruptcy Act Revision, 94th Cong., 1st Sess., Hearings on H.R. 31 and 32, Part I, at 439 (1976) [hereinafter House Hearings] (prepared statement of Patrick A. Murphy, Esq.) (emphasis added). See also *Id.* at 489-93.

Another witness, testifying on behalf of the American Bankers Association, said:

> A related change in both bills would extend the jurisdiction of the Bankruptcy Court to secured creditors in possession of property of the bankrupt, which would, with appropriate safeguards, permit the Bankruptcy Court to force the secured creditor to surrender that property to the debtor or trustee even in a straight bankruptcy case. Assuming that adequate safeguards of the rights of se-

> cured creditors are contained in the legislation, we would support this change recognizing that is is a power that is present in reorganization cases under existing law [citing §§ 256 and 257 of Ch. X and §§ 506 and 507 of Ch. XII and *RFC* v. *Kaplan.]* It should be made clear by statute, however, that the Bankruptcy Court would have no power to administer any secured creditor's collateral unless (1) there is an equity for the benefit of creditors or unless such administration is necessary to effect a rehabilitation under Chapter VI or VII of the Commission's Bill or Chapters VI, VII, or VIII of the Judge's Bill, and (2) it is clear that the value of the secured creditor's claim against the collateral will be preserved.

Id. at 1023 (prepared statement of Walter W. Vaughn).

The National Bankruptcy Conference expressed the same view of the matter:

> However, the NBC [National Bankruptcy Conference] noted that there is no provision either in the reorganization chapter or elsewhere comparable to existing Section 257 of Chapter X. This Section authorizes the Court to require a mortgagee or other secured creditor to turn over to a trustee property in his possession. In view of the expanded jurisdiction of the Bankruptcy Court under the proposed bills, it is also clear that this power should continue in the Court and the NBC concluded that it should be extended to liquidation cases.
>
> The following principles are therefore recommended: (1) the right to gain possession from a secured creditor should exist in both liquidation and reorganization cases. (2) Some standard or guidelines, even if only of a general nature should be established as to the occasions when such rights should be exercised. (3) The standards or guidelines in liquidation cases should be those contained in Section 5-203 and in reorganization cases those in Section 7-203 [the forerunner of the current adequate protection section].

Id. at 1838-39. [16] See also *Id.* at 1756-57 (prepared statement of Robert J. Grimmig, Vice-President, Chemical Bank); Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary, The Bankruptcy Reform Act, Hearings on S. 235 and S. 236, Part I, at 125 (statement of Walter Vaughn) and 464 (statement of Robert Grimmig) (1976).

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[16] The revision suggested by the National Bankruptcy Conference would have amended § 4-603 of H.R. 31 and 32 (quoted at not 14, *supra*) as follows:

> Section 4-603. Effect of Filing of Petition on Prior Custodian of Debtor's Property *and Creditor in Possession.*
>
> (a) Applicability of Section. If when a petition is filed under this Act [the]property of the debtor is in the possession of:
>
> (1) a receiver, trustee, or other officer of a nonbankruptcy court, or
>
> (2) an assignee under a general assignment for the benefit of creditors, or
>
> (3) a trustee or agent under a statute or contract, who is appointed or authorized to take charge of the property for the purpose of enforcing a lien against the property of the debtor or of a general administration of the debtor's property for the benefit of creditors, or
>
> (4) *a creditor*
>
> the custodian's *or creditor's* rights and duties respecting the property shall be governed by this section.
>
> (b) *Duty of Custodian or Creditor to Deliver Property and Make Accounting.* A custodian [of the debtor's property] or creditor to whom this section applies [shall] *may be directed by the court to deliver the property in his possession to the trustee of the debtor's estate under this Act [and] for the purpose of sale under section 5-103 in a case under Chapter V, for the purpose of sale returning the property to the debtor subject to any relief from the stay prescribed by section 4-501 in a case under Chapter VI, or for the purposes of use pursuant to section 7-203 or disposition pursuant to section 7-104, 7-205, or 7-303(9) in a case under Chapter VII or IX.*

A Note prepared by the NBC to accompany the proposed change read:

The proposed addition to the title of the Commission's §4-603 and the proposed addtion of clause (4) to subsection (a) are designed to make clear that the section applies to a mortgagee or other creditor in posssession of some or all of the property of the debtor as do §§ 257 and 507 of the present Act. *In re Colonial Realty Investment Co.*, 516 F.2d 154 (1st Cir. 1975); *In re Franklin Garden Apartments.* 124 F.2d 451 (2d Cir. 1941).

Commentary on the proposed bankruptcy legislation reflected the same understanding. One article, Murphy, *Use of Collateral in Business Rehabilitation: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 Calif. L. Rev. 1483 (1975), said:

> Two questions are presented: (1) does the court have the power to stay the secured creditor from commencing or continuing a foreclosure action; and (2) does the court have the power to order a secured creditor in possession to surrender the property for use in the rehabilitative process? Section 7-203 of the Proposed Act contemplates the use of collateral but fails to deal with the initial question of obtaining the property from a secured creditor in possession. Section 2-201 of the Proposed Act is clearly intended to extend the jurisdiction of the court to property of the estate whereever located and, when read with section 4-501, would permit the court to *stay* a secured creditor in possession even in straight bankruptcy proceeding—clearly a change from existing law. However, neither the Proposed Act nor the Judge's Bill deals expressly with the *recovery* of property from secured creditors in possession.

Id. at 1497 (footnotes omitted). The article continued:

> Expanded jurisdiction under section 2-201, in combination with the broad definition of "property of the estate" under section 4-601, indicates that the Commission intended to give the court power to deal with collateral in the possession of secured creditors. This should be clarified, however, in the general part of the legislation, Chapter IV of the Proposed Act, rather than in Chapter VII, in order for the court to have comprehensive power in liquidation proceedings and in the rehabilitative chapters.

Id. at 1497-98. See also Coogan, *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 Bus. Law. 1149, 1169-78 (1975); Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law 15 (1974).

Shortly after the uncontradicted statements regarding the bankruptcy court's turnover power, cited above, were made to the House and Senate subcommittees, § 542, the Code's general turnover provision, was added to the proposed legislation.

Following this addition, the provision was incorporated in all later drafts of the bill, and the turnover question, which had attracted substantial attention in the 1975 and 1976 hearings, was not mentioned in subsequent legislative history. This sequence of events compels the inference that § 542 was added to the Code to make clear—as a number of witnesses had explicitly urged—that the turn-over power approved in *RFC* v. *Kaplan* was to be incorporated in the new statute. This inference becomes all the more compelling when one considers that if § 542 did not authorize compelling turnovers by secured creditors in possession, apparently its only use would be to authorize obtaining property from persons in wrongful possession following theft or conversion. Given the circumstances surrounding the inclusion of the section in the Code, the more natural reading of § 542 is that it was intended to codify *RFC* v. *Kaplan*, and possibly, although we need not decide the question, also extend the turnover power to straight bankruptcy cases.

For the foregoing reasons, we reject the Government's reading of §§ 542, 541 and 363 in the present context of a Chapter 11 proceeding, and hold that in such a case the bankruptcy court generally has power under § 542 to order the turnover of property repossessed or executed upon by a secured creditor or held by a pledgee following the debtor's default and prior to his bankruptcy, if the property has not yet been sold. We thus pass on to the Government's further argument that, even if the bankruptcy court can compel a turnover by a repossessing or executing lender under § 542 in a Chapter 11 proceeding, this cannot be done in the case of property upon which the IRS had levied.

III. *Federal Tax Levies*

On the basis of a mere reading of the IRC provisions, the argument is unpersuasive. Comparison of relevant statutes indicates that an IRS levy on tangible property pursuant to § 6331 *et seq.* is virtually indistinguishable from the ordinary repossession and foreclosure procedures followed by secured creditors, except for the fact that the IRS can make its own

levy without need of the assistance of a sheriff, marshal or similar officer. Compare § 6331 *et seq.* of the IRC with §§ 9-207. 9-501 to 507 of the UCC and with N.Y. Lien Law §§ 200-05 (public sales), N.Y. Lien Law §§ 206-210 (levy) and with §§ 1301 *et seq.* of the New York Real Property Actions and Proceedings Law. In these instances as under IRC § 6331 *et seq.*, the statutes give the debtor the right, and only the right, to notice, an opportunity for redemption, and surplus proceeds.

The Government's argument for a sharp distinction between an IRS levy and a secured creditor's repossession is based primarily on *Phelps* v. *United States*, 421 U.S. 330 (1975). In *Phelps*, a taxpayer had transferred its assets to an assignee for the benefit of creditors, who had converted them into some $38,000 in cash. The Government filed a notice of tax lien in the amount of $140,831.59 and levied upon the $38,000 in the assignee's hands. An involuntary petition in bankruptcy was then filed against the taxpayer, and a receiver in bankruptcy petitioned the bankruptcy court to require the assignee to turn over the proceeds. The Seventh Circuit ruled against the receiver, 495 F.2d 1283 (1974), on the ground that the assignee was holding for the benefit of the United States as an adverse claimant, thereby implicating the rule that in ordinary bankruptcy such a holder is not subject to summary jurisdiction. It disagreed with the Ninth Circuit's decision in *In re General Wood Products Corp.*, 483 F.2d 975 (1973), that an assignee's disclaimer of interest brought similarly seized property within the summary jurisdiction of the bankruptcy court under language in *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U.S. 426, 432-33 (1924), and that the possession of the bankrupt necessary to support exercise of summary jurisdiction in ordinary bankruptcy existed "where the property is held by some other person who makes no claim to it." The Supreme Court granted certiorari to resolve the conflict.

The Supreme Court agreed with the Seventh Circuit. It reasoned that, following the levy, the assignee held the $38,000 on behalf of the United States as an adverse claimant. The Court then applied the settled rule that "where possession is

assertedly held not for the bankrupt, but for others prior to bankruptcy . . . the holder is not subject to summary jurisdiction." *Phelps*, *supra*, 421 U.S. at 335-36 (quoting 2 Collier on Bankruptcy ¶ 23.06[3], at 506.2-506.3 (14th ed. 1975)). The receiver's case was not aided by § 2a(21) of the Bankruptcy Act which authorized bankruptcy courts to require turnovers by assignees for the benefit of creditors since, as a result of the levy, the assignee was holding not for creditors generally but as a custodian for the United States.

It is plain that the *holding* in *Phelps* does not assist the Government here. *Phelps* was one in the line of cases applying the distinction between summary and plenary jurisdiction that had evolved under the 1898 Act with respect to ordinary bankruptcy, see *Taubel-Scott-Kitzmiller Co.* v. *Fox*, *supra*, 264 U.S. 426, where decision hinged on whether or not the trustee had actual or constructive possession of the debtor's property. Under the Code this distinction no longer exists, as the legislative history makes clear, see, e.g., Senate Report No. 95-989 (1978) at 153, *reprinted in*, [1978] U.S. Code Cong. & Ad. News 5939; House Report No. 95-595 (1978) at 445, *reprinted in*, [1978] U.S. Code Cong. & Ad. News 6400. Instead, Congress adopted a broad jurisdictional provision which states, in language modeled on § 111 of Chapter X of the former Act, "The bankruptcy court . . . shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of [the] case." 28 U.S.C. § 1471(e). Hence it is far from clear that under the Code a bankruptcy court would not have *power* to order a turnover on the same facts as in *Phelps*. [17]

Moreover *Phelps* did not decide that a bankruptcy court would not have had power in a Chapter X proceeding under the former Act to direct a turnover on facts such as there presented. As we have previously developed, the constraints

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[17] We emphasize the word "power" since it is hard to see what proper purpose a turnover would have in straight bankruptcy on the facts of *Phelps*.

against a bankruptcy court's exercising summary jurisdiction with respect to property of the bankrupt not in the debtor's actual or constructive possession had never applied under the reorganization provisions, §§ 77 and 77B, and Chapters X and XII. Rather, "the reorganization court [could] bring its authority to bear upon creditors in situations not possible in ordinary bankruptcy." 6 Collier on Bankruptcy ¶ 3.03, at 412 (14th ed. 1977). In such cases

> when possession of the debtor's property is held by a creditor, such as a pledgee or mortgagee, whose claim is not in dispute and who does not dispute the debtor's title but claims the right to hold the property and use it as security, the courts have generally ruled that this possession is not sufficient to defeat the reorganization court's summary jurisdiction either to enjoin the use of the security as by sale or to retake possession thereof.

6 Collier on Bankruptcy ¶ 3.05, at 431 (14th ed. 1977). See *Reconstruction Finance Corporation* v. *Kaplan*, *supra*, and cases cited at pp. 11-12, *supra*. As shown above the framers of the Code intended to preserve this jurisdiction.

The Government is thus forced to argue that after an IRS levy, as distinguished from levies by other secured creditors, a debtor loses not only possession but ownership. This position finds scant support in the language of IRC § 6331 *et seq*. Looking only at the statute, we would see no basis for doubt that at the commencement of the Chapter 11 proceeding Whiting had title to the goods the IRS had seized. Under the statute ownership is extinguished not by the levy and seizure but only by a subsequent sale. Thus, § 6335(a) requires that written notice of seizure be given "to the owner of the property (or, in the case of personal property, the possessor thereof)" or be left at his usual place of abode or business. Section 6335(b) requires that, as soon as practicable after the seizure, notice of sale be given to "the owner". Section 6336, relating to perishable goods, again requires notice to the "owner of the property". The IRS's certificate of sale of personal property shall "transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold", § 6339(a)(2), and its deed of real

property "shall be considered and operate as a conveyance of the right, title and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereto." § 6339(b)(2). By the very language of the statute, it is the delinquent party's interest, not an interest already acquired by the Government as a result of the levy, that is conveyed. Nothing in these sections prohibits the delinquent party, after the levy and pending the sale, from exercising the most fundamental right of ownership, namely, to transfer title, subject, of course, to the continuing right of the United States to proceed with the sale unless the property has been redeemed under § 6337(a). Such a transfer could well occur when the taxpayer's equity was substantial. It thus is not surprising that in *Bennett* v. *Hunter*, 76 U.S. (9 Wall.) 326, 336-37 (1870), addressing itself to a statutory scheme essentially the same as IRC § 6331 *et seq.*, the Court had said:

> What preceded the sale was merely preliminary, and, independently of the sale, worked no divestiture of title.

The title was "forfeited" by the levy only in the sense that "it became subject to be vested in the United States, and upon public sale, became actually vested in the United States or in any other purchaser, but not before such public sale."

In the face of all this the Government relies on two statements in the *Phelps* opinion. One, 421 U.S. at 337, is that "The levy, therefore, gave the United States full legal right to the $38,000 levied upon as against the claim of the petitioner receiver". The statement that the United States had "full legal right" to the $38,000 levied upon for a much larger tax liability is not equivalent to saying that where, as here, the debtor has an equity in the property, that also passes to the Government. Any such statement—and, we repeat, none was made—not only would have been unnecessary to the decision but would have run directly counter to *Bennett* v. *Hunter*, *supra*, which was not called to the Court's attention either in the briefs or in oral argument and was not cited by it.

The other statement in *Phelps* on which the Government relies is in footnote 8, 421 U.S. at 337. The footnote dealt with

an argument by the receiver based on § 70a(8), which vested a trustee in bankruptcy "with the title of the bankrupt as of the date of the filing of the petition . . . to . . . property held by an assignee for the benefit of creditors." The Court's first answer was the receiver's admission that at the date of the filing of the petition, the bankrupt had no title to property it had previously conveyed to the assignee. The footnote then added:

> In any event, the pre-bankruptcy levy displaced any title of Chicagoland [the taxpayer], and § 70a(8) is therefore inapplicable.

The footnote cited no authority for the proposition that the levy as distinguished from the sale "displaced" the title of Chicagoland, which the receiver had conceded to be non-existent because of the prior conveyance to the assignee, and any such view, if applied generally, would run directly counter to *Bennett* v. *Hunter*, *supra*. The remark just quoted must be read as addressed to the particular circumstances of the *Phelps* case, where the tax claim vastly exceeded the amount of the levy and the seizure was of cash which did not need to be sold. See *United States* v. *Pittman*, 449 F.2d 623, 627 (7 Cir. 1971). [18]

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[18] The Government relies also on cases in the courts of appeals to support its thesis that a levy under § 6331 *et seq.* strips the debtor of ownership despite the contrary implications of the statutory language and *Bennett* v. *Hunter*, *supra*. The general thrust of the decisions, as distinguished from some of the language, is to the contrary. *In re brewster-Raymond Co.* 344 F.2d 903 (6 Cir. 1965), held that a debt owing to the bankrupt on which the Government had levied prior to adjudication but the proceeds of which had not been turned over to it remained part of the bankrupt estate so as to trigger § 57j, which prohibited the collection of tax penalties that had been included in the levy. United States v. Sullivan, 333 F.2d 100 (3 Cir. 1964) (in banc), although paraphrasing, at p. 116, the language in *United States* v. *Eiland*, 223 F.2d 118, 121 (4 Cir. 1955), a case cited in *Phelps*, 421 U.S. at 336, that a levy "effects a seizure of the deliquent's property tantamount to a transferal of ownership", held

In deciding this case it is appropriate for us to look, as the Supreme Court would equally be obliged to look, not only to the two statements in *Phelps* but to the legislative history of the Bankruptcy Code. Both the House and the Senate Reports, H.R. Rep. No. 95-595, 95th Cong. 1st Sess. at 367 (1977); S. Rep. No. 95-989, 95th Cong. 2d Sess. at 82 (1978), said that § 541(a) included

> property recovered by the trustee under section 542 of proposed title 11, if the property received was merely out of the possession of the debtor, yet remained property of the debtor.

and that

> The debtor's interest in property also included "title" to property, which is an interest, just as are a possessory interest, or a leasehold interest, for example.

Despite the Government's assertions to the contrary, our conclusion that an IRS levy on tangible property in which the debtor has an equity does not strip the debtor of all property interests and transfer full title to the Government is entirely consistent with the statements in the House and Senate Re-

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that the levy did not allow the Government to recover from insurance policy loans and automatic premium loans made after service of the notice of the levy. *Eiland* itself held only that in an ordinary bankruptcy a referee could not compel a debtor of the bankrupt on whose debt the United States had levied for a much larger tax to pay the debt to the trustee rather than the United States; the court suggested that a different result might obtain if the case involved tangible property, 223 F.2d at 123. *United States* v. *Pittman*, *supra*, 449 F.2d 623, while presenting textual arguments that, in its view although not in ours, would support a conclusion that the levy itself transferred title to the Government and citing *Eiland*, *supra*, ended up by saying, at p. 627:

> *Eiland* involved the levy upon an intangible indebtedness rather than upon corporeal property as here and we would hesitate to extend its holding. Such a step is not necessary to the decision of this case.

ports, H.R. Rep. No. 95-595, *supra*, at 367-68; Sen. Rep. No. 95-989, *supra*, at 82, see also 124 Cong. Rec. H 11096 (daily ed. Sept. 28, 1978), that the Code was "not intended to expand the debtor's rights against others more than they exist at the commencement of the case" and that the trustee "could take no greater right than the debtor himself had." Whiting has not asked us to invalidate the tax lien. It has asked only to have the use of the property, on which the IRS had levied but which it had not yet sold, in what Whiting believed and the bankruptcy judge found might be a successful rehabilitation, to the advantage of the Government as well as other interested parties. Here we must give some weight to the purpose of the Code, announced by Representative Edwards, a member of the Commission on the Bankruptcy Laws of the United States, who presented the bill to the House, 124 Cong. Rec. H 11089 (daily ed. Sept. 28, 1978):

> The amendment also encourages business reorganizations by a streamlined new commercial reorganization chapter. . . . It will protect the investing public, protect jobs, and help save troubled businesses.

There can be no doubt that allowing the government to strip a failing company of all its tangible property would impact seriously on this goal. [19]

We recognize that, as said in *Bull* v. *United States*, 295 U.S. 247, 259-60 (1935), "taxes are the life-blood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection. The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt." Such considerations are of peculiar force

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[19] For the impact of IRS levies upon businesses seeking to reorganize, see Nowak. *Turnover Following Prepetition Levy of Distraint Under Bankruptcy Code § 542*, 55 Am. Bankruptcy L.J. 313, 313-14 (1981) (citing findings of Senate subcommittee investigation of IRS collection efforts).

when, as here, a debtor has simply helped itself to amounts withheld from employees. The framers of the Code sought to reconcile the possibly conflicting goals of enhancing the prospects for rehabilitation and protecting the revenue by the provision in § 363(e) for adequate protection of the subject of a turnover order to which we have already referred, *supra*, note 3. The nature of what § 363(e) means by "adequate protection" is spelled out in § 361, quoted at note 3, *supra*. If a plan of reorganization is ultimately effectuated, the United States, as holder of a perfected lien, would be entitled to the protections afforded by § 1129(b)(2)(A); it could not be treated, over its objection, simply as an unsecured priority creditor. However, a successful reorganization is by no means assured; there have been all too many instances where creditors, even secured creditors, have seen their interests whittled away while the debtor and its counsel endlessly pursue some will of the wisp after all real hope has faded. A bankruptcy judge acting on a request like that made here should therefore give serious consideration to forms of protection other than that ultimately obtainable in a reorganization plan. [20]

Here the bankruptcy judge purported to do just that, see note 5, *supra*, and we would have little doubt that the conditions he developed would be sufficient except for one point not apparent on the face of his opinion. The opinion of the district court reveals that, in addition to the turnover order of April 28, 1981, here before us, the bankruptcy judge made an order on April 30, 1981, directing Bankers Trust Company to pay certain levied funds to the IRS and further directing that such funds [21] be considered as partial payment of the $20,000 which Whiting was required to pay the IRS under the order

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[20] The judges must also vigilantly monitor the results of business operations and the progress of attempts at reorganization.

[21] The Government tells us, Brief at 5, fn. 3, that these amounted to nearly $15,000. It objects to the consideration of such funds, which it deems to be its own, as part of the down payment.

here under review. The district judge vacated the April 30 order and directed the bankruptcy court to reconsider it. We are not clear what the effect of this was. There is nothing to indicate whether Whiting had appealed from the April 30 order, and the direction that the Bankers Trust funds be considered as partial payment of the $20,000 on the turnover of the tangibles would fade away if the April 28 order were vacated as the district court directed. The April 30 order is not before us and perhaps may never be. We also have no idea what has been happening in the year since the levy and the filing of the Chapter 11 petition. Under the circumstances we think it best simply to reverse the order of the district court insofar as it held that the tangible assets were not subject to a turnover order, and remand to it with instructions to vacate its own order to that effect and remand to the bankruptcy court for further proceedings consistent with this opinion. In such proceedings the bankruptcy court should consider whether a turnover order is appropriate under present circumstances and, if it decides in the affirmative, what protection should be afforded to the United States.

It is so ordered.

APPENDIX B

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

CASE NO. 81-20063
81-2034A

In re

WHITING POOLS, INC.,

Debtor.

UNITED STATES OF AMERICA,

Plaintiff,

vs

WHITING POOLS, INC.,

Defendant.

MEMORANDUM AND DECISION

The United States of America has commenced an action under 11 U.S.C. § 362(d) of the new Bankruptcy Code seeking a determination that the automatic stay provisions of Bankruptcy Code 11 U.S.C. § 362(a) are not applicable to it with respect to certain property seized by the Internal Revenue Service from Whiting Pools, Inc. to satisfy unpaid employment taxes; or alternatively, seeking relief from the automatic stay provisions of 11 U.S.C. § 362 to permit the Internal Revenue Service to sell the seized property. A preliminary hearing was held within 30 days after the filing of the complaint and was continued to a final hearing. The final hearing has been held. Both parties have submitted memorandums of law and all testimony has been taken.

From the hearings, the facts appear to be as follows. Whiting Pools, Inc. filed a petition under Chapter 11 of the Bankruptcy Code on or about January 15, 1981. Whiting Pools, Inc., the debtor in this proceeding, is engaged in the business of selling, installing and servicing swimming pools. It also retails

pool equipment and supplies from its place of business at 7244 Palmyra Road, Fairport, New York. On January 14, 1981, the United States acting through the Internal Revenue Service seized all of the debtor's property at its place of business. The seizure included nearly all of the debtor's tangible property. The United States proposes to sell this property at public auction or otherwise in accordance with sections 6331 *et. seq.* of the Internal Revenue Code. It is seeking the permission of this Court to conduct such a sale. The property seized includes equipment, vehicles, inventory, office equipment and supplies. The United States claims to be owed approximately $92,000 in back employment taxes.

The issues presented to the Court are: First, can the Internal Revenue Service proceed with its sale of the seized property without permission of the Bankruptcy Court; second, if the Service is bound by the provisions of 11 U.S.C. § 362(a), should the stay be lifted pursuant to § 362(d); and third, if the stay is continued, can this Court order the Service to turnover the seized property to the debtor so that rehabilitation of the debtor can be effected. Each of these issues will be addressed in turn.

Whether the Service needs permission of this Court to proceed with its sale of the debtor's property depends on the applicability of the automatic stay provisions of 11 U.S.C. § 362. Section 362(a) provides in pertinent part as follows:

> 362(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay, applicable to all entities, of-
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title:
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title . . .

The automatic stay applies to the Service under either of these paragraphs. The seized property, although in the custody of the Service, is, nevertheless, property of the debtor. Title to the property never passed to the Service or to anyone

else. Any doubt about the debtor's continued ownership of the property is soon dispelled upon the reading of § 6335 of the Internal Revenue Code of 1954 which provides for the sale of seized property. That section repeatedly refers to the taxpayer as the *owner* of the property. Therefore, paragraph 5 clearly applies in this case. Furthermore, even if the seizure had divested the debtor of title to the property, paragraph 6 would prevent the Service from unilaterally exercising its right to sell the property since such a sale would constitute an act to collect a claim against the debtor. *See In re Avery Health Center, Inc.*, Civil Action No. 81-51E, BK 81-10130, 3 CBC 728 (W.D.N.Y. Jan. 28, 1981).

Having decided that the automatic stay is applicable to the Service with respect to the seized property we must now consider whether the stay should be continued or lifted. Here, the relevant section of the Code is § 362(d) which provides as follows:

> 362(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay-
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
>
> (2) with respect to a stay of an act against property, if-
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization.

It is readily apparent that the Service cannot succeed in lifting the stay under paragraph 2. The hearings required by 11 U.S.C. § 362(d) have been held and this Court finds with regard to those hearings that the property of the debtor is worth $162,876 as a going concern and that the only liens against that property are a tax lien of $92,000 and Marine Midland's security interest which is either $6,000 or $12,500 depending upon the outcome of litigation which involves par-

ties not before this Court. Thus, the provisions of subparagraph A are not met since the debtor has substantial equity in the property.

Furthermore, the seized property is absolutely necessary to an effective reorganization of the debtor. The Service has seized virtually everything this debtor owns. If the stay is lifted and the sale occurs, the debtor will cease to exist. Therefore, even if the debtor had no equity in the seized property, the stay could not be lifted pursuant to paragraph 2 since the provision of subparagraph B cannot be satisfied.

Therefore, the Service must show cause, pursuant to paragraph 1, why the stay should be lifted. The sole cause advanced by the Service is that the United States is incurring rent of $2,500 per month while it waits to sell the property.

Taking into account the testimony adduced by the Service, their forced sale (the proceeds of which are subject to prior lien) will probably net a maximum of $30 to $35,000 and the more probable recovery will be in the neighborhood of $20,000. The extra expense incurred as a result of the stay of sale is substantial in light of the minimal recovery expected from the forced sale.

Significantly, the Service has not argued that it lacks adequate protection for the harm wrought by the imposition or continuation of the stay. Apparently, the reason for this is that a business without access to its property is in no position to offer such protection and it would be inconsistent for the Service to hold the property and demand protection at the same time.

It is abundantly clear to this Court that the United States' interest in the property can adequately be protected if the debtor's property is returned to it and its business is recommenced. This Court also feels that such a turnover is in the best interests of both parties and would accomplish the purpose of both the Bankruptcy and Internal Revenue Codes. The United States can realize more on its tax claim from the income of a revitalized business than from the proceeds of a forced sale. Nevertheless, the Service insists that it be permitted to sell the property at auction and further insists that this Court

cannot order a turnover of pre-petition seized property. Since it makes little sense to continue the stay unless a turnover of property can accompany the stay, we now turn to the most critical issue of this case; *i.e.*, the power of a Bankruptcy Court to order the turnover of property in the hands of a creditor incident to the enforcement of a lien.

To begin with, the question of whether property seized by the Service prior to the filing of a bankruptcy petition is property of the estate as defined by § 541 of the Code and thus subject to the turnover provisions of § 542 has already been addressed in this district. *In the Matter of Avery Health Center, Inc.*, 3 CBC 728 (W.D.N.Y. 1981) Judge Elfin concluded that only those property interests remaining in the debtor at the time it filed its petition could be considered property of the estate as defined by § 541. Having found that the debtor was not entitled to use, lease, or otherwise possess the seized property at the time it filed its petition, Judge Elfin held that "the IRS may not be ordered to turn over the levied property under § 542 of the Bankruptcy Code." *Id* at 732.

Judge Elfin approached the problem by considering in turn § 542, § 363 and § 541. His attention was focused primarily on § 541 and he held close to the clear, plain and literal terms of that section. Simple logic, operating on the plain language of the Code and the information available to him, necessarily led him to the conclusion he reached.

This Court cannot argue with Judge Elfin's logic but neither can it accept an interpretation of the Code that strips a reorganization court of the power to order a turnover of pre-petition seized property necessary to the successful rehabilitation of Chapter 11 debtors. Such power was lodged in this Court under the Act and Congress could not have intended to limit that power when it enacted the Code.

Under the Act, the source of the Court's power to order the turnover of property was § 2(a)(21), which, in Chapter X cases, was supplemented by § 257. Clause 21 required receivers or trustees appointed in other proceedings, assignees for the benefit of creditors and liquidation agents to turnover to the trustee in bankruptcy all property that was the property of the

debtor before it came into the hands of such receiver, trustee or assignee.

In cases arising under this section, the courts distinguished between "equity receivers" and "foreclosure receivers". *See Emil* v. *Hanley*, 311 U.S. 515 (1942) and *Tuttle* v. *Harris*, 297 U.S. 225 (1935). Essentially, the former was a receiver, trustee, assignee or agent who held the debtor's property for the benefit of creditors generally. The latter were entities who had possession of the debtor's property incident to the enforcement of a lien.

Another distinction drawn, not only by the courts but by the Act itself, was the different treatment of property in the hands of a "foreclosure receiver" depending on whether the proceedings at bar contemplated reorganization or straight bankruptcy. In straight bankruptcy, only property in the hands of an "equity receiver" was subject to the turnover provisions of § 2(a)(21), *Emil* v. *Hanley*, *supra*. Property held by or for a creditor incident to the enforcement of a lien was not reachable by the trustee in bankruptcy unless he could successfully challenge the validity of the underlying lien in a plenary suit. *Phelps* v. *United States*, 421 U.S. 330 (1975).

On the other hand, in reorganization cases, § 2(a)(21) was read in conjunction with § 257. Section 257, which applied only to Chapter X cases, provided:

> § 257. The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. *The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.* (Emphasis added)

It was the intent of Congress in enacting this section to make clear the inapplicability under Chapter X of the equity-foreclosure distinction. *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791, 795 (1st Cir. 1950). Thus, in reorganization cases, not only was property in the hands of an "equity receiver" subject to the turnover provisions of § 2(a)(21) but so also was

the property in the possession of "foreclosure trustees". *Emil* v. *Hanley, supra* at 522. The reason for this is obvious. In order to undertake successfully the rehabilitation of a corporate debtor it was necessary that a reorganization court be empowered to take possession of all the debtor's property wherever located and regardless of the nature of the debtor's possession. *See generally*, Collier (14th Ed.) ¶ 14.03; *see also*, *In Re Prudence-Bonds Corp.*, 77 F. 2d 328 (2d Cir. 1935).

Thus, at least since the enactment of § 257, it has been firmly established that a reorganization court is empowered to order the turnover of proerty in the hands of a trustee or receiver incident to the enforcement of a lien. *Emil* v. *Hanley, supra*. It was also well established that the turnover provisions were not limited to property in the hands of court appointed officers having the title of "trustee" or "receiver" or "agent". Creditors in possession of the debtor's property incident to enforcement of a lien came within the meaning of "foreclosure receiver". *See Reconstruction Finance Corp.* v. *Kaplan, supra; In re Franklin Garden Apartments*, 124 F. 2d 451 (2d Cir. 1941); and *In re Third Avenue Transit Corp.*, 198 F. 2d 703 (2d Cir. 1952). This was the state of the law prior to the enactment of the new Code. Where did these broad turnover powers go when the Act was repealed and the Code went into effect?

Section 542 and 543 are the only express turnover provisions in the new Code. Since the *Avery* case has rendered the former inapplicable, the applicability of the latter must now be determined. Section 543 applies only to property in the hands of custodians and provides in part as follows:

> § 543(b) A custodian shall-
>
> (1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodians possession, custody or control on the date that such custodian acquires knowledge of the commencement of the cases . . .

Whether § 543 applies to the Service in a case such as ours turns on whether the Service is a custodian within the meaning of § 101(10) which provides in pertinent part:

§ 101(10) "custodian" means-

(c) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtors' creditors

For the purposes of our case the essential terms of clause (c) are these: A custodian includes an agent under applicable law authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property. There is a familiar ring to this language. This definition of custodian, in one of its aspects, appears to be the latter-day description of a "foreclosure trustee". It would appear, therefore, that one type of entity subject to the turnover provision of § 543 is the same kind of entity treated as a "foreclosure trustee" in cases decided under the Act.

As has already been observed, these entitites included mortgages under a mortgage, pledgees pursuant to a factor lien agreement, trustee under a trust deed and the like. Is there any distinction worth drawing between the Service in possession of seized property and a mortgagee in possession of property under a mortgage? This Court thinks not. When the Service filed its tax lien it became, in effect, a lien creditor with respect to all of the debtor's property. By seizing the property, the Service did not change the nature of its interest from a lien interest to ownership; all it did was take another step in the process of enforcing its lien.

The United States' reliance on *Phelps* v. *United States*, 421 U.S. 370 (1975) in support of its contention that seizure is tantamount to ownership, is misplaced. All the courts that have addressed the issue at bar have distinguished *Phelps* on the ground that it only dealt with the old summary vs. plenary jurisdiction of the bankruptcy courts under the Act. But *Phelps* is inapposite for another, more important reason.

The *Phelps* court was dealing with a straight bankruptcy case, not a reorganization case. As was discussed above, property in the hands of a "foreclosure trustee" could not be the

subject of a turnover order in straight bankruptcy. In effect, the *Phelps* court held that the assignee in that case was holding the disputed funds not as a mere naked bailee for creditors generally (i.e. equity receiver) but as a custodian for the United States, a bona fide adverse claimant (i.e. "foreclosure trustee"). *Phelps* at 337. All the talk about "ownership" cropped up in the context of the courts jurisdiction, vel non, over property in the hands of, or being held for, an adverse claimant. In Chapter IV this was a crucial issue. *See generally* Collier (14th Ed.) ¶ 23.06 p 494 *et seq.* Under Chapter X, the nature of a claimant's (or debtor's) possession was rendered largely irrelevant by § 257 and other provisions of the Act that gave a reorganization court expanded jurisdiction and extra powers that were considered neither necessary nor appropriate in Chapter IV cases. *See, Emil* v. *Hanley, supra.* Therefore, any language in *Phelps* that can be construed to mean that ownership of the seized property passed from the debtor to the Service is dicta merely and is completely inapplicable to the case at bar. Once we shed all the "tantamount to ownership" talk and the related exercise of balancing the respective rights of the Service and the debtor in the seized property, what remains is this:

The Service has *custody* of the debtor's property incident to the enforcement of its lien. Certainly, the Service has a very substantial interest in the seized property, but no more so than a mortgagee foreclosing upon real property of a debtor who has a receiver appointed to take possession of the property prior to the filing of a petition. The fact that the Service itself has custody of the debtor's property and not a court-appointed officer is of no consequence. Therefore, the Service in possession of pre-petition seized property must be considered a custodian within the meaning of § 101(10)(c) and thus subject to the turnover provisions of § 543.

The only question remaining is whether this court should order the turnover of the seized property or excuse compliance pursuant to § 543(d). In deciding this question, the pre-code cases again are instructive. Under the Act, the powers given a bankruptcy court by § 257 were considered drastic powers to

be exercised only in the most "extraordinary circumstances". *In re Third Avenue Transit Corp.*, *supra* at 706; *see also RFC* v. *Kaplan*, *supra*; *In re Franklin Garden Apartments*, *supra*. In the *Third Avenue Transit* case, the Second Circuit Court of Appeals established the following guidelines for determining what was an appropriate case for a turnover order:

> 1. The use of the property must be necessary to the successful rehabilitation of the debtor,
>
> 2. The debtor can be reorganized in accordance with the Act within a reasonable period of time, and
>
> 3. The entity that is being dispossessed of its security will not be injured thereby.

If these guidelines are applied to the case at bar, it is seen that the use of the seized property is absolutely necessary to the debtor's survival. Without the use of its equipment, inventory and other items seized by the Service, surely the debtor must fold. From testimony taken at the hearings, the preliminary hearing and the final hearing, it appears that the debtor has a reasonable chance to reorganize and become a profitable business again. But a turnover of the seized property should not be ordered if the United States will be injured thereby. The debtor abused a fidicuary duty of the highest order when if failed to pay the taxes it withheld from its employees' wages and the ability of the Service to recover those taxes should not unreasonably be impaired.

It is important to note here that unlike § 542, § 543 does not expressly provide for adequate protection. Section 543(d), literally applied, would seem to permit either an unconditional turnover or maintenance of the status quo depending on which course best serves the interests of creditors. In this case, such a literal interpretation creates an intolerable dilemma. For this reason, § 542 would seem the more appropriate section for resolving the controversary at bar because it incorporates by reference the terms of § 363(e) which permits a court to condition any turnover order upon the ability of the debtor to give adequate protection. *See* Collier (15th Ed.) ¶ 363.04 at 362-23 (illustrating the treatment under the Code of the *RFC* v.

Kaplan Scenario and discussing the interrelationship of §§ 542, 363 and 362).

In any event, the ability of this Court to fashion a just remedy should not be limited by reading § 543(d) to literally. Whether the courts' turnover power is properly found in §§ 542, 543 or even § 105 (to carry out the purpose of the automatic stay as was the case in *RFC* v. *Kaplan)* the Court must have the concommitant power to require adequate protection.

Therefore, to accomplish the purposes of both the Bankruptcy and Internal Revenue Codes, the Service must release the seized property to the debtor-in-possession upon the following conditions:

1. That the debtor-in-possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and

2. That the debtor shall pay to IRS the sum of $1,000 a month until the tax is paid, and

3. That during this period of time IRS shall retain its lien upon the property seized, and

4. That if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted,

and it is so ordered.

Date: April 28, 1981

Edward D. Hayes
EDWARD D. HAYES
Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

CASE NO. 81-20063
81-2034A

In re

WHITING POOLS, INC.,

Debtor.

UNITED STATES OF AMERICA,

Plaintiff,

vs

WHITING POOLS, INC.,

Defendant.

ORDER

At Rochester, New York in the said District on the day of April, 1981.

In accordance with the attached Findings of Fact and Conclusions of Law, it is

ORDERED that IRS turn back the property seized to the debtor in possession, and it is further

ORDERED that the debtor in possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and it is further

ORDERED that the debtor shall pay to IRS the sume of $1,000 a month until the tax is paid, and it is further

ORDERED that during this period of time IRS shall retain its lien upon the property seized, and it is further

ORDERED that if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted.

ENTER:

Edward D. Hayes
EDWARD D. HAYES
Bankruptcy Judge

APPENDIX C

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In re
WHITING POOLS, INC.,

Debtor.

CIV-81-362B(E)

Received June 19, 1981
United States Attorney

MEMORANDUM AND ORDER

This is an appeal from an order of the Bankruptcy Court which would require the Internal Revenue Service ("the IRS") to turn over to the debtor property which the IRS had levied upon and seized. My Order filed May 6, 1981 stayed the effect of the Bankruptcy Court's order pending disposition of this appeal. For the reasons set out below, I am reversing that court's order.

The debtor, Whiting Pools, Inc., sells, installs and services swimming pools and pool equipment and supplies and maintains a place of business located in Fairport, N.Y. The IRS made an assessment of tax against the debtor for unpaid employment taxes owing for the third and fourth quarters of 1979 and the second and third quarters of 1980. Despite the IRS's demand for payment, the unpaid balance of such assessment is approximately $92,000. Pursuant to a warrant issued by the United States Magistrate, the IRS entered the debtor's place of business January 14, 1981 and levied upon and seized the debtor's inventory, equipment and other personal property. The debtor filed a petition under Chapter 11 of the Bankruptcy Code January 15, 1981. The IRS commenced an adversary proceeding for a determination by the Bankruptcy Court that the automatic stay provisions of the Bankruptcy Code, 11 U.S.C. § 362, are inapplicable to its proposed sale of the levied property. The debtor counterclaimed for an order requiring the IRS to turn over the levied property.

After an evidentiary hearing, [1] the Bankruptcy Court entered an order April 28, 1981 requiring the IRS to turn over the levied property to the debtor. The court conditioned this relief upon the debtor's payment of $20,000 to the IRS prior to turnover and $1,000 monthly thereafter. Under the terms of the court's order, the debtor's failure to make said monthly payment would automatically cause the order to be lifted.

The Bankruptcy Code contains two provisions which pertain to the turnover of property to the debtor. 11 U.S.C. §§ 542, 543. Section 542 generally requires any entity, other than a custodian, in possession of property of the estate to deliver said property to the trustee. [2] Section 543 requires a custodian to deliver to the trustee any property of the debtor that is in the custodian's possession on the date that the custodian learns of the commencement of the bankruptcy case. [3] In a recent case

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[1] The Bankruptcy Court conducted an evidentiary hearing on two separate days. Neither the IRS nor the debtor has requested that a transcript of said hearing be included in the record. Inasmuch as the underlying facts are not disputed and the issue presented herein is a legal one concerning the Bankruptcy Court's power to order a turnover of the levied property, I have not requested the preparation of a transcript.

[2] Section 542(a) provides as follows:

"* * * [A]n entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, * * * shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate."

Section 363 authorizes the trustee to use, sell, or lease "property of the estate." "Property of the estate" is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1).

[3] Section 543(b) states that a custodian shall:

> "deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody or control on the date that such custodian acquires knowledge of the commencement of the case * * *."

arising under virtually identical circumstances as the present one, I held that the IRS may not be required under section 542 to turn over to the debtor property that had been levied upon and seized prior to the commencement of the case. *In re Avery Health Center, Inc.*, 3 C.B.C.2d 728 (W.D.N.Y. 1981). The Bankruptcy Judge recognized that *Avery Health Center, Inc.* forecloses application of section 542 to require the IRS to turn over the levied property in the present case. Nevertheless, he concluded that the IRS is a custodian of property of the debtor within the meaning of section 543 and therefore ordered the turnover of the property pursuant to that section.

The relevant definition of the term custodian is set out in section 101(10)(C) of the Bankruptcy Code, which states that "custodian" means:

> "trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors * * *."

The Bankruptcy Judge focused on the language of section 101(10)(C) indicating that a custodian is an "agent" authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property. [4]

Although the Bankruptcy Code does not contain a definition of the term "agent," the concept of agency entails a fiduciary relationship arising out of an express or implied contract between the principal and the agent. Thus, it has been held that a secured creditor in possession of property taken from a debtor pursuant to the terms of a security agreement is an agent and therefore a custodian within the meaning of section 101(10)(C). *Matter of Williams*, 3 C.B.C.2d 84 (B.Ct. E.D. Mich. 1980). In

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[4] There has been no contention on this appeal that the IRS is a "trustee" or a "receiver" as those terms are used to define a custodian.

the present case, however, there is no contractual understanding between the IRS and the debtor from which an agency relationship may be said to have arisen. [5]

Section 101(10)(C) also indicates that a custodian may be an "agent under applicable law * * *." The provisions of the Internal Revenue Code which authorize the IRS to levy upon and seize a taxpayer's property, 26 U.S.C. § 6331, do not purport to create an agency relationship. Rather, the IRS given the authority to sell the levied property subject to few restrictions. [6]

A levy by the IRS "is substantially broader in scope than anything known to the common law * * *." *United States* v. *Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964). Thus, courts have indicated that a tax levy "is 'an absolute appropriation in law,' and a seizure of the property levied upon, tantamount to a

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[5] The Bankruptcy Judge noted that under the Bankruptcy Act of 1898 a mortgagee, pledgee or trustee under a trust deed could be ordered to turn over property of the debtor in a reorganization proceeding. *See, e.g., In re Third Ave Transit Corp.*, 198 F.2d 703 (2d Cir. 1952); *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950); *In re Franklin Garden Apartments*, 124 F.2d 451 (2d Cir. 1941). Finding no reason to distinguish between such persons and the IRS, the Bankruptcy Judge concluded that section 543 must apply to property upon which the IRS has levied. However, the existence of a contract giving rise to an agency relationship is a crucial distinction between the cases cited by the Bankruptcy Judge and the present case.

[6] After levy upon and seizure of the property, the IRS may sell the property upon the following conditions: (1) the proceeds of the sale must be applied toward payment of the underlying tax liability, (2) any surplus remaining after payment of the tax liability and the expenses of sale must be returned to the taxpayer (or other lien creditors), and (3) the taxpayer may redeem the property prior to sale by tendering payment of the tax liability. 26 U.S.C. §§ 6337, 6342. The Internal Revenue Code also prescribes certain procedures to be used in connection with the sale. 26 U.S.C. § 6335.

transfer of ownership." *United States* v. *Pittman*, 449 F.2d 623, 626 (7th Cir. 1971). *See, also, Phelps* v. *United States*, 421 U.S. 330, 337, n.8 (1975) ("the prebankruptcy levy displaced any title of [the debtor]"); *Matter of Pittsburgh Penguins Partners*, 598 F.2d 1299, 1302 (3d Cir. 1979); *Am. Acceptance Corp.* v. *Glendora Better Builders*, 550 F.2d 1220, 1222-3 (9th Cir. 1977) (upon levy and seizure of the property, "all rights were held by the IRS"); *United States* v. *Sullivan*, *supra*, at 116 (a levy "effects a seizure of the delinquent's property tantamount to a transferal of ownership"); *Matter of Chantler Baking Co.*, 436 F.Supp. 169, 174 (W.D.Pa. 1977) ("a tax levy operated to endow IRS with *all* rights in the seized property"). These cases make clear that the IRS, after levying upon and seizing a taxpayer's property, is not a mere "agent" or "custodian" of the property. I accordingly hold that the IRS is not a custodian subject to the turnover provisions of Bankruptcy Code § 543.

The Bankruptcy Court's order which would require the IRS to turn over the levied property to the debtor is hereby ORDERED reversed. The case is remanded to the Bankruptcy Court for a determination whether the stay of the IRS's proposed sale of the levied property imposed by Bankruptcy Code § 362 should be terminated. [7] The Bankruptcy Court

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[7] The Bankruptcy Court held that the automatic stay provisions of section 362 apply to the IRS's proposed sale of the levied property. The IRS has not appealed from that aspect of the court's decision.

The IRS seeks to be released from the stay "for cause" under Bankruptcy Code § 362(d)(1). As the Bankruptcy Court previously noted, "it makes little sense to continue the stay unless a turnover of property can accompany the stay."

shall also reconsider, in light of this decision, its order dated April 30, 1981 directing Banker's Trust Company to pay certain levied funds to the IRS and further directing that such funds be considered as partial payment of the $20,000 which the debtor was required to pay to the IRS.

Dated: Buffalo, N.Y.
June 16, 1981

/s/ John T. Elfin
JOHN T. ELFIN
U.S.D.J.

APPENDIX D

STATUTES

11 U.S.C. (Supp. IV) (Bankruptcy Code):

§ 363. *Use, sale, or lease of property*

* * * * *

(b) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

* * * * *

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section only to the extent not inconsistent with any relief granted under section 362(c), 362(d), 362(e), or 362(f) of this title.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that this has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

* * * * *

§ 541. *Property of the estate*

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, whereever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) An interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date ——

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include any power that the debtor may only exercise solely for the benefit of an entity other than the debtor.

* * * * *

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortage or interest, becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

* * * * *

§ 542. Turnover of property to the estate

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 552 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C.):

§ 6331. *LEVY AND DISTRAINT.*

(a) [as amended by Section 1906(b)(13)(A), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520]. *Authority of Secretary.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency of instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary makes a finding that the

collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

* * * * *

(b) [as amended by Section 104(a), Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125 and Section 1209(d), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1710] *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. Except as otherwise provided in subsection (d)(3), a levy shall extend only to property possessed and obligations existing at the time thereof. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

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